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1 Before United States Board of Tax Appeals

Docket No. 86,849

WALTER C. JANNEY AND PAULINE F. M. JANNEY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: Bernhard Knollenberg, Esq., for taxpayer. James D. Head, Jr., for Commissioner.

Docket entries

Oct. 8, 1936—Petition received and filed. Taxpayer notified. (Fee paid.)
Oct. 9, 1936—Copy of petition served on General Counsel.
Nov. 24, 1936—Answer filed by General Counsel.
Nov. 28, 1936—Copy of answer served on taxpayer.
Sept. 8, 1937—Hearing set Nov. 16, 1937.
Nov. 16, 1937—Hearing had before Mr. Black on merits. Submitted.
Nov. 16, 1937—Stipulation of facts filed. Pet's brief due 1/2/37. Respondent's brief due 2/3/37. Reply 2/18/38.
Nov. 29, 1937—Transcript of hearing Nov. 16, 1937, filed.
Jan. 3, 1939—Brief filed by taxpayer. 1/3/38 copy served on General Counsel.
2 Feb. 10, 1938—Motion for leave to file respondent's brief, brief lodged filed by Geenral Counsel. 2/11/38 granted.
Jan. 31. 1939—Opinion rendered, Mr. Black, Div. 15. Decision will be entered under Rule 50.
Feb. 23, 1939—Computation of deficiency filed by General Counsel.
Feb. 28, 1939—Hearing set March 15, 1939, on settlement.
Mar. 3, 1939—Consent to settlement filed by taxpayer.
Mar. 9, 1939—Decision entered, Eugene Black, Div. 15.
Apr. 26, 1939—Petition for review by United States Circuit Court of Appeals, Third Circuit, with assignments of error filed by taxpayer.
Apr. 29, 1939—Proof of service filed by taxpayer.
May 9, 1939—Praecipe for record filed, with proof of service thereon. No counter praecipe will be filed.

CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, ~~1939~~ 1940

No. ~~845~~ 36

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WALTER C. JANNEY AND PAULINE F. M. JANNEY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 26, 1940

CERTIORARI GRANTED APRIL 29, 1940

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SUPREME COURT OF THE UNITED STATES

October Term, 1939

No. 843

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WALTER C. JANNEY AND PAULINE F. M. JANNEY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

3 Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed October 8, 1936

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:B-2, EYL-90D) dated July 29, 1936, and as a basis for their proceeding allege as follows:

1. The petitioners are husband and wife; they are citizens of the United States, and reside at Bryn Mawr, Pennsylvania.

2. On information and belief the notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioners on July 28, 1936.

3. The taxes in controversy are income taxes for the calendar year 1934, and in the amount of thirty-seven thousand one hundred nine dollars and twenty-nine cents ($37,109.29).

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

The respondent has erroneously disallowed a loss of $89,963.35, sustained by the petitioner, Walter C. Janney, upon the sale of capital assets during said year 1934, notwithstanding the
4 inclusion in the petitioners' joint return for said year 1934
of gains, from the sale of capital assets by the petitioner, Pauline F. M. Janney, in the amount of $94,491; in contravention of Sections 51 (b) and 117 (d) of the Revenue Act of 1934.

The respondent has erroneously attributed a capital loss of $729.82 (appearing in the petitioners' joint return as an item in arriving at a net income of $21,564.31 from the W. C. Janney trust) to the petitioner Walter C. Janney, whereas in fact said W. C. Janney trust was created by the petitioner Pauline F. M. Janney and said capital loss should be attributed to her, and allowed as a deduction against the capital gains of said petitioner, Pauline F. M. Janney, in any event.

5. The facts upon which the petitioners rely as a basis for this proceeding are as follows:

First Assignment of Error

(a) The petitioners are husband and wife and were living together at the close of the taxable year 1934.

(b) The petitioners filed a joint income tax return for the calendar year 1934.

(c) During the year 1934 the petitioner, Pauline F. M. Janney, realized gains from the sale of capital assets, of which the percentage to be taken into account, under Section 117 (a) of the Revenue Act of 1934, was $94,491.

(d) During the year 1934 the petitioner, Walter C. Janney, sustained losses from the sale of capital assets, of which the percentage to be taken into account under Section 117 (a) of the Revenue Act of 1934 was $91,963.35.

(e) In their joint income tax return for the year 1934 the petitioners reported the aforesaid gains and losses from the sale of capital assets, deducting said losses in the amount of $91,963.35 from said gains in the amount of $94,491, leaving a net gain reported in said income tax return of $2,527.65.

5 (f) The respondent disallowed said deduction to the extent of $89,963.35, on the alleged ground that "the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets."

Second Assignment of Error

(g) On July 7, 1926, by a revocable deed of trust, the petitioner, Pauline F. M. Janney, conveyed to Walter C. Janney, as Trustee, a certain property to be held by said Trustee upon the trusts set forth in said deed.

(h) During the year 1934 net income in the amount of $21,564.31 was received from said trust property, after deducting a loss from the sale of capital assets in the amount of $729.82.

(i) In the aforesaid joint income tax return petitioners reported said net income of $21,564.31 received by the petitioner, Pauline F. M. Janney, as grantor in said revocable deed of trust, and said capital loss of $729.82.

(j) During the year 1934 the petitioner Pauline F. M. Janney realized gains from the sale of capital assets in the amount of $94,491, as alleged in paragraph 4 (c) hereof.

(k) The respondent, in his determination of the deficiency herein, disallowed the deduction of said capital loss of $729.82.

Wherefore the petitioners pray that this Board may hear the proceeding and determine:

(a) That the extent to which the losses sustained by the petitioner, Walter C. Janney, from the sale of capital assets, shall be allowed, shall be the sum of $2,000 plus the gains realized by his wife, the petitioner Pauline F. M. Janney, from the sale of capital assets.

6 (b) That the capital loss of $729.82 sustained in connection with the trust created on July 7, 1926, was sustained by

the petitioner, Pauline F. M. Janney, and that said loss be allowed in full.

(c) That there is no deficiency in the petitioners' income tax for the year 1934.

BERNHARD KNOLLENBERG,
Counsel for Petitioners,
25 Broadway, New York, N. Y.

[*Duly sworn to by Walter C. Janney and Pauline F. M. Janney; jurats omitted in printing.*]

7 *Exhibit A to petition*

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, July 28, 1936.

Mr. WALTER C. JANNEY and
Mrs. PAULINE F. M. JANNEY
(Husband and Wife)
Bryn Mawr, Pennsylvania.

SIR and MADAM:

You are advised that the determination of your income tax liability for the taxable year 1934 discloses a deficiency of $37,109.29 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

8 Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By (Sgd.) CHAS. T. RUSSELL,
Deputy Commissioner.

Enclosures:
Statement.
Form 870.

STATEMENT

IT: AR: B-2.
EYL-90D.

In re Mr. Walter C. Janney and Mrs. Pauline F. M. Janney (Husband and Wife), Bryn Mawr, Pennsylvania

INCOME TAX LIABILITY

Year, 1934; Income Tax Liability, $38,758.20; Income Tax Assessed, $1,648.91; Deficiency, $37,109.29.

The deficiency shown herein is based upon the report dated April 25, 1936, prepared by Revenue Agent J. T. Jamieson, a copy of which was transmitted to you under date of May 21, 1936.

9 The computation of tax is as follows:

Net income reported on return, line 20		$26,160.30
Plus:		
1. Increase in fiduciary income	$729.82	
2. Decrease in loss	89,963.35	
		90,693.17
Adjusted net income		$116,853.47
Less: Exemption		2,900.00
Income subject to surtax		$113,953.47
Less:		
Dividends	$21,170.50	
Earned income credit	300.00	
		21,470.50
Subject to normal tax		$92,482.97
Normal tax at 4% on $92,482.97		3,699.32
Surtax on $113,953.47		35,255.80
Total tax		$38,955.12
Less: Tax paid at source		196.92
Tax assessable		$38,758.20
Tax previously assessed, account #217014		1,648.91
Deficiency		$37,109.29

EXPLANATION OF CHANGES

1. It is noted you reported a net amount of $21,564.31 from the W. C. Janney Trust. Included in this amount, however, was a capital loss of $729.82. Inasmuch as this trust was revocable, the capital loss has been transferred from line 6 to line 8 and included in your total capital loss.

10 The disallowance of the capital loss of $729.82 from trust income results in an increase in fiduciary income of $729.82.

2. Information on file in the Bureau discloses you claimed a loss of $91,963.35 from sales of stocks and bonds which was offset against a gain of $94,491.00 on transactions of your wife and a net gain of $2,527.65 reported on your joint return. Article 117–5 of Regulations 86, states that in the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

Section 117 (d) of the Revenue Act of 1934 states that losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000.00 plus the gains from such sales or exchanges.

Therefore, your capital loss is limited to an amount of $2,000.00. Since a loss of $91,963.35 was claimed, there is an increase in income of $89,963.35.

Reference is made to your letter dated June 26, 1936, addressed to the Commissioner of Internal Revenue in which you stated that when you received a ninety-day letter giving you the right to appeal to the United States Board of Tax Appeals, you planned to take an appeal to the Board in the hope that the Board will overrule the Commissioner's adverse ruling in this and similar cases.

In view of the above ninety-day letter is now being forwarded.

11 Before United States Board of Tax Appeals

Answer

Filed November 24, 1936

Comes now the Commissioner of Internal Revenue, by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for answer to the petition filed by the above-named petitioners, admits and denies as follows:

1, 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1934. Denies all other allegations contained in paragraph 3 of the petition.

4. Denies that the respondent committed error as alleged in paragraph 4 of the petition.

5 (a), (b), (c). Admits the allegations contained in subparagraphs (a), (b), and (c) of paragraph 5 of the petition.

5 (d). Denies the allegations contained in subparagraph (d) of paragraph 5 of the petition.

5 (e). Admits that in their joint income tax return for the year 1934, the petitioners reported gains realized by petitioner Pauline F. M. Janney from the sale of capital assets in the amount of $94,491 and deducted from said gains the claimed capital losses alleged to have been sustained by petitioner Walter C. Janney in the amount of $91,963.35. Denies all other allegations contained in subparagraph (e) of paragraph 5 of the petition.

5 (f). Admits that the respondent disallowed the claimed deduction for losses alleged to have been sustained by petitioner Walter C. Janney from the sale of capital assets to the ex-
12 tent of $89,963.35. Denies all other allegations contained in subparagraph (f) of paragraph 5 of the petition.

5. (g). Admits that in the calendar year 1934 certain property was held in a revocable trust by Walter C. Janney, trustee, but for lack of information sufficient to form a belief as to the truth or falsity thereof, denies that said property was conveyed to Walter C. Janney, as trustee, by petitioner Pauline F. M. Janney on July 7, 1926, as alleged in subparagraph (g) of paragraph 5 of the petition. Denies all other allegations contained in subparagraph (g) of paragraph 5 of the petition.

5 (h). Admits the allegations contained in subparagraph (h) of paragraph 5 of the petition.

5 (i). Admits that in their joint income tax return petitioners reported net income received from a trust of which Walter C. Janney was trustee in the amount of $21,564.31 after deducting a capital loss of $729.82. Denies all other allegations contained in subparagraph (i) of paragraph 5 of the petition.

5 (j). Admits that during the year 1934 the petitioner Pauline F. M. Janney realized gains from the sale of capital assets of which the percentage to be taken into account under Section 117 (a) of the Revenue Act of 1934 was $94,491. Denies all other allegations contained in subparagraph (j) of paragraph 5 of the petition.

5 (k). Admits that the respondent in his determination of the deficiency herein, disallowed to petitioner Pauline F. M. Janney, a deduction of said capital loss of $729.82 but qualifies the admission by alleging that respondent determined that said capital loss of $729.82 was a loss of petitioner Walter C. Janney who was allowed a deduction for capital losses to the extent of the statutory limit of $2,000 under the provisions of Section 117 (d) of the Revenue Act of 1934, all of which is shown in the notice of deficiency.

13 6. Denies generally and specifically each and every allegation contained in taxpayers' petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the appeal be denied.

(Sgd.) HERMAN OLIPHANT,
General Counsel for the Department of the Treasury.

Of Counsel:
CHESTER A. GWINN,
JAMES D. HEAD, Jr.,
Special Attorneys,
Bureau of Internal Revenue.

14 Before United States Board of Tax Appeals

Stipulation of facts

Filed November 16, 1937

It is hereby stipulated and agreed, by and between the parties hereto, through their respective attorneys of record, that, for the purposes of this proceeding only, the following facts may be taken as true without prejudice to the right of either party to introduce other evidence at the hearing of this cause:

1. Petitioners Walter C. Janney and Pauline F. M. Janney are husband and wife and reside at Bryn Mawr, Pennsylvania.

2. The petitioners on March 15, 1935, filed with the Collector of Internal Revenue for the First District of Pennsylvania, whose office is located in Philadelphia, Pennsylvania, a single joint Federal income tax return for the calendar year 1934. There is attached hereto and made a part hereof and marked Exhibit I a photostat copy of the petitioners' joint Federal income tax return for the calendar year 1934.

3. Within the statutory period of limitation, on July 28, 1936, the respondent, pursuant to the provisions of Section 272 (a) of the Revenue Act of 1934, mailed to the petitioners by registered mail a notice of deficiency. A true copy of said notice of deficiency is attached to the petition filed October 8, 1936, as "Exhibit A" and the same is hereby by reference made a part of this stipulation of facts.

4. During the calendar year 1934, the petitioner Pauline F. M. Janney sold various capital assets as defined in Section 117 (b) of the Revenue Act of 1934. The following table shows the gains and losses realized by her on the sales of such capital assets and

the amount of such gains and losses to be taken into account under Section 117 (a) of the Revenue Act of 1934:

15 Capital assets sold	Gains	Losses	Net gain or loss	Percentage to be taken into account under Section 117 (a) of the Revenue Act of 1934	
				Percentage	Amount
(1) Held less than one year	$6,290.00	($662.50)	$5,627.50	100%	$5,627.50
(2) Held from one to two years	98,133.55	($535.00)	97,598.55	80%	78,078.84
(3) Held from two to five years	7,768.39		7,768.39	60%	4,661.03
(4) Held from five to ten years	15,309.08		15,309.08	40%	6,123.63
Totals	$127,501.02	($1,197.50)	$126,303.52		$94,491.00

5. During the calendar year 1934, the petitioner Walter C. Janney sold various capital assets as defined in Section 117 (b) of the Revenue Act of 1934. The following table shows the gains and losses realized by him on the sales of such capital assets and the amount of such gains and losses to be taken into account under Section 117 (a) of the Revenue Act of 1934:

16 Capital assets sold	Gains	Losses	Net gain or loss	Percentage to be taken into account under Section 117 (a) of the Revenue Act of 1934	
				Percentage	Amount
(1) Held less than one year	None	None		100%	None
(2) Held from one to two years	$1,679.79	($566.49)	$1,113.30	80%	$890.64
(3) Held from two to five years		(20,669.28)	(20,669.28)	60%	(12,401.57)
(4) Held from five to ten years		(201,131.08)	(201,131.08)	40%	(80,452.43)
Totals	$1,679.79	[1]($222,366.85)	($220,687.06)		($91,963.36)

[1] In addition to the above, petitioner sustained a loss of $7,177.81 on sales of securities to a corporation in which he owned more than 50 percent. of the stock. Such loss, however, is not deductible under the provisions of Section 24 (a) (6) of the Revenue Act of 1934.

17 6. On line 8 of their joint Federal income tax return for the calendar year 1934 under the heading of "capital gain" the petitioners reported the sum of $2,527.65. The method by which said sum of $2,527.65 was computed is shown in Schedule C attached to the petitioners' joint Federal income tax return for the calendar year 1934. In said Schedule C the adjusted loss of petitioner Walter C. Janney from the sale or exchange of capital assets as set forth in paragraph 5 of this stipulation in the amount of $91,963.35 was deducted from the adjusted gain of Pauline F. M. Janney from the sale of capital assets as set forth in paragraph 4 of this stipulation in the amount of $94,491 and the difference of $2,527.65 constitutes the amount reported as

capital gain on line 8 of petitioners' joint Federal income tax return for the calendar year 1934.

7. In determining the deficiency from which this appeal is taken, the respondent, in accordance with the provisions of Article 117-5 of Regulations 86, determined that the losses of petitioner Walter C. Janney from sales or exchanges of capital assets could not be applied to reduce the gains realized by petitioner Pauline F. M. Janney from the sale of capital assets. Accordingly, respondent refused to permit the losses of petitioner Walter C. Janney from the sale or exchange of capital assets in the amount of $91,963.35 to be offset against the gains from the sale of capital assets in the amount of $94,491 realized by petitioner Pauline F. M. Janney for the purpose of computing their net taxable income for the calendar year 1934, except to the extent of the $2,000 limitation provided for by Section 117 (d) of the Revenue Act of 1934. By reason of such holding the respondent increased the capital gain reported by petitioners on line 8 of their joint Federal income tax return for the calendar year 1934 by an amount of $89,963.35. The amount of $89,963.35 is the amount by which the losses suffered by petitioner Walter C. Janney from the sale or exchange of capital assets in the
18 amount of $91,963.35 exceeds the amount of the $2,000 limitation provided for in Section 117 (d) of the Revenue Act of 1934.

8. On line 6 of their joint Federal income tax return for the calendar year 1934, the petitioners reported as "income from fiduciaries" the sum of $24,803.34. Included in said sum of $24,803.34 was a net amount of $21,564.31 constituting income for the year 1934 of a revocable trust, of which Walter C. Janney was trustee. Petitioner Pauline F. M. Janney was the grantor of said trust, and the income thereof is includable in computing her net income for the calendar year 1934 under the provisions of Section 166 of the Revenue Act of 1934.

9. The net amount of $21,564.31 reported by petitioners as income of the revocable trust referred to in paragraph 8 of this stipulation consisted of the following:

Interest	$2,483.20
Interest 2% tax-free covenant	8,250.00
Royalties	285.93
Dividends	11,395.00
	$22,414.13
Capital losses	729.82
	$21,684.31
Taxes paid	120.00
	$21,564.31

10. In determining the deficiency from which this appeal is taken respondent increased the income from fiduciaries reported by petitioners in their joint return by the sum of $729.82, representing the capital loss of the revocable trust as set forth in paragraph 9 of this stipulation, and determined that the said sum of $729.82 was a capital loss attributable to petitioner Walter C. Janney. It is agreed that the action of the respondent in increasing the income from fiduciaries reported by peti-
19 tioners in their joint return for the calendar year by the
sum of $729.82 was correct; but that said sum of $729.82 is a capital loss attributable to petitioner Pauline F. M. Janney, and not to petitioner Walter C. Janney as determined by respondent.

BERNHARD KNOLLENBERG,
Counsel for Petitioners.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

W.P.A

INDIVIDUAL INCOME TAX RETURN

For Calendar Year 1934

WALTER C. JANNEY & PAULINE F. M. JANNEY

Bryn Mawr, Penna.

Citizen

1st Pa.

Cash

Prepared by ... & Co.

Income

1. Salaries, Wages, Commissions, Fees, etc.

Brokerage

Director's Fees ... 00

Schedule attached

7. LOSS

DEDUCTIONS

COMPUTATION OF TAX

22. Less: Personal exemption 2500 00

23. Credit for Dependents 400 00

AFFIDAVIT

AFFIDAVIT

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25 RE—1934 INCOME TAX RETURN OF WALTER C. JANNEY AND PAULINE F. M. JANNEY

Item 1—Salaries, Wages, Commissions, Fees, etc.—Director's Fees

The Autocar Co., Ardmore, Pa	$180.00
Boone County Coal Corporation, Sharples, W. Va	70.00
2nd & 3d Streets Passenger Railway Co., Philadelphia	60.00
Warner Company, Philadelphia	75.00
	$385.00

WALTER C. JANNEY AND PAULINE F. M. JANNEY—JOINT FEDERAL TAX RETURN FOR YEAR 1934

Item 6—Income from Fiduciaries

Walter C. Janney, Trustee, 1529 Walnut St., Philadelphia		$21,564.31
Comprising:		
Interest	$2,483.20	
Interest 2% Tax Free Covenant	8,250.00	
Royalties	285.93	
Dividends	11,395.00	
	$22,414.13	
Capital Net Loss	729.82	
	$21,684.31	
Taxes Paid	120.00	
	$21,564.31	
26 Girard Trust Co., Philadelphia, Fiduciary Estate Israel Morris Trust—Normal Income		3,198.33
Heirs of Anna Morris, deceased, Agency Acct. Net Rentals—Samuel W. Morris, Executor, % Girard Trust Co., Philadelphia		6.42
Estate Frederick W. Morris, deceased, Normal Income		34.28
		$24,803.34

RE—1934 INCOME TAX RETURN OF WALTER C. JANNEY AND PAULINE F. M. JANNEY

Item 7—(from Schedule B) Bryn Mawr Real Estate

Rents received		$4,423.58
Less:		
Depreciation	$1,605.00	
Taxes	1,163.96	
Mortgage Interest	1,326.00	
Insurance	245.81	
Repairs, Fuel, etc	982.13	
Commissions	222.78	5,545.68
Net Loss		(—)$1,122.10

Kimberton Farms

Income—			
Rents	$2,558.10		
Pasture	295.00		
Hay	16.00		
Miscellaneous	.63	2,869.73	
27 Less:			
Depreciation	$5,235.00		
Expenses—Taxes	1,246.83		
Insurance	329.96		
Repairs and Expenses	1,027.83	7,839.62	
Net Loss			(—)$4,969.89
Total Losses			(—)$6,091.99

Bryan Mawr Cottage

Rent received	1,224.00	
Less: Repairs	75.52	
Net Gain		1,148.48
Loss		(—)$4,943.51

In addition to above there was a new bathroom installed at cost of $602.02.

WALTER C. JANNEY AND PAULINE F. M. JANNEY

Schedule "E"—Dividends Received

R. J. Reynolds Tobacco Co., Winston-Salem, N. C.	$7.500.00
Bryn Mawr Trust Co., Bryn Mawr, Pa	40.00
Northern States Power Co. of Delaware, Chicago, Ill	100.00
Philadelphia Bourse Co., Philadelphia, Pa	3.00
General Electric Co., Schenectady, N. Y	5,500.00
Bryn Mawr Ice Manufacturing & Cold Storage Co., Bryn Mawr, Pa	142.50
Second & Third St. Passenger Rwy. Co., Philadelphia, Penna	90.00
Fourth National Investors Corporation, New York City	1,050.00
28 Third National Investors Corporation, New York City	200.00
Insurance Co. of North America, Philadelphia, Pa	1,000.00
State Street Investment Corporation, Boston, Mass	4,000.00
Sun Oil Co., Philadelphia, Pa	795.00
Electric Storage Battery Co., Philadelphia, Pa	750.00
Total	$21,170.50

The above are included on the Tax Return as follows:

Item #6	$11,395.00
Item #10	9,775.50
	$21,170.50

RE—1934 INCOME TAX RETURN OF MR. WALTER C. JANNEY

Schedule "F"—Item 14—Taxes Paid—Real Estate, etc.

Radnor Township, Pa.:			
(July)		$989.83	
(Sept. W. C.)		2,280.97	
Town of Falmouth, Mass. (Oct. W. C.)		2,128.77	
Town of Fairhaven, Mass.		30.40	
			$5,429.97

Club Dues

Mill Dam	$8.00		
Rittenhouse	15.00		
Racquet	15.00		
Radnor Hunt	10.00		
Union League	12.50		
Pickering Hunt	2.50		
Treweryn Beagles	2.00		
Merion Cricket	21.00		
29 Philadelphia	18.50		
Acorn	6.00		
Springdale Golf (N. J.)	3.50		
Woods Hole Golf (Mass.)	15.00		
Boca Raton, (Fla.)	10.00		
Gulf Stream Golf (Fla.)	30.00		
			169.00

Automobile and Miscellaneous

Penna. Dept. of Revenue (tags, etc.)		$100.40	
Mass. State tax (gasoline)		43.56	
		$143.96	

Checks

Penna. Co., etc. Phila.	$19.74		
Falmouth (Mass.) Nat. Bk.	1.18	20.92	

Telephone

Bell Tel. Co. of Pa.	$9.90		
New England Tel. & Tel. Co.	13.48	23.38	
S. S. Tickets, U. S. Revenue Tax		20.00	
Safe Deposit Box (Girard Tr. Co., Phila.)		10.00	218.26
			$5,817.23

Dividends

W. C. Janney		54.32	
Mrs. P. F. M. Janney		48.75	103.07
Stamps on Stock Transfers			7.00
			$5,927.30

30 RE—1934 INCOME TAX RETURN OF WALTER C. JANNEY AND PAULINE F. M. JANNEY

Schedule "F"—Item 17—Contributions made by Mr. Walter C. Janney

United Campaign, Philadelphia	$1,000.00
American Red Cross	275.00
Bryn Mawr Hospital, Bryn Mawr, Pa	250.00
Church of The Redeemer, Bryn Mawr, Pa	243.75
Salvation Army	100.00
Monthly Meeting of Friends, Philadelphia	50.00
Cape Cod Hospital, Hyannis, Mass	25.00
Falmouth Historical Society, Falmouth, Mass	25.00
Playground & Recreation Asso., Philadelphia	25.00
Chester Co. Council Boy Scouts, West Chester, Pa	25.00
Girl Scouts, Philadelphia	25.00
Haverford College, Haverford, Pa., Lecture Fund, &c	20.00
University Museum, Philadelphia	12.00
Public Baths Asso. of Philadelphia	10.00
Mass. Forest & Park Asso., Boston, Mass	10.00
Penn Normal Ind. & Agr. School, Frogmore, S. C.	10.00
"The Pines," Conshohocken, Pa	10.00
Academy of Natural Sciences, Philadelphia	10.00
Fairmount Park Art Asso., Philadelphia	5.00
Valley Forge Historical Society, Valley Forge, Pa	5.00
31 National Missions of the Presbytery, Philadelphia	5.00
Fairmount Park Guard Pension Fund, Philadelphia	5.00
Rush Hospital, Philadelphia	3.50
Florence Crittenden Home, Philadelphia	3.00
Friends Historical Asso., Philadelphia	2.00
Delaware Co. Tuberculosis Asso., Chester, Pa	2.00
Child Welfare Federation, Philadelphia	1.00
	$2,157.25

Contributions made by Mrs. Pauline F. M. Janney

National Recreation Association of New York	100.00
Church Farm School, Glen Loch, Pa	100.00
Total	$2,357.25

Mr. and Mrs. Walter C. Janney, 1529 Walnut Street, Philadelphia, Pennsylvania.—Rider to Item 8.

In computing the capital gain of $2,527.65 set forth in Item 8 of the attached joint return, capital losses of $91,963.35 sustained by Mr. Janney have been offset against capital gains of Mrs. Janney. The amount of Mr. Janney's losses is separately shown in Schedule C of the return so that if the method of computing capital gain followed by the taxpayers is not allowed by the Bureau the deficiency can be readily determined.

The taxpayers have followed the method outlined above in computing the capital gain reported in the attached joint
32 return, instead of the method set forth in the Treasury Regulations, for the reason that they desire to lay the foundation for an appeal to the United States Board of Tax Appeals from the provision in the Regulations that the capital losses of one spouse cannot be offset against capital gains of the other spouse in a joint return. It is submitted that there is nothing in the statute which justifies treatment of capital losses in any different manner from that of interest, taxes, contributions, and ordinary losses, which spouses filing joint returns have for upwards of fifteen years been permitted to deduct in full. That no exception to the general rule was made by the Bureau in the case of gains and losses is established by the following letter from Commissioner Burnet, dated December 29, 1932, quoted on Page 465 of Montgomery's "Federal Tax Hand Book for 1934–5," reading as follows:

"In the case of a husband and wife who file a joint income tax return * * * such joint return is treated as if it were the return of a single individual. In the case of gains and losses from transactions falling within the same class within the meaning of the statute, such as sales of securities not held for a period of more than two years, the loss sustained by the husband would offset the same amount of gain realized by the wife from such source."

Congress' reenactment in the 1934 Act of the language relating to joint returns of the earlier Acts must, in the light of the consistent and long established administrative construction of that language, be recognized as an adoption by Congress of the established administrative construction. National Lead Company v. United States, 252 U. S. 140.

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ITEM 8

SCHEDULE C

AMOUNT	SECURITY	ADDRESS	DATE PURCHASED	DATE SOLD	COST	AMOUNT RECEIVED	TOTAL PROFIT OR LOSS	100% LESS THAN ONE YEAR	80% ONE TO TWO YEARS	60% TWO TO FIVE YEARS	40% FIVE TO TEN YEARS
213 SHARES	AUTOCAR CO 6% PFD	ARDMORE PA	10/29/28 TO 10/28/29	11/19/34	19841 40	2206 09	17635 31 L				17635 31 L
864 SHARES	BOONE COUNTY COAL CORP PFD	SHARPLES W VA	12/28/26	9/18/34	51840 00	31760 64	20079 36 L				20079 36 L
100 SHARES	BOONE COUNTY COAL V T CTF	SHARPLES W VA	12/28/26	1/15/34	6000 00	3000 00	3000 00 L				3000 00 L
7000 SHARES	GENERAL ELECTRIC CO	SCHENECTADY N Y	NOV 1925 Janney	10/26/34 TO 12/28/34	140967 52	133482 89	7484 63 L				7484 63 L
$3000	MISSOURI PACIFIC 5¼% 1949	ST LOUIS MO	6/20/33	12/5/34	702 83	136 34	566 49 L		566 49 L		
100 SHARES	NORTHERN STATES POWER A	CHICAGO ILL	12/31/31	12/5/34	22730 22	2060 94	20669 28 L			20669 28 L	
2000 SHARES	PENNA TRUST CO READING PART CTF	READING PA	4/21/27	12/31/34	66119 00	1 00	66118 00 L				66118 00 L
1686 4/5 SHARES	RADIO CORP OF AMER	NEW YORK N Y	2/23/33	12/17/34 TO 12/20/34	6562 50	8242 29	1679 79		1679 79		
1164 SHARES	SELECTED INDUSTRIES CONV PFD	JERSEY CITY N J	2/1/29	12/28/34	90792 00	3978 22	86813 78 L				86813 78 L
7418 SHARES	BOONE COUNTY COAL CORP COM	SHARPLES W VA	12/28/26	12/21/34	115141 25	110787 54	4353 71 L *				
696 SHARES	BOONE COUNTY COAL CORP PFD	SHARPLES W VA	12/28/26	12/21/34	40231 06	38115 48	2115 58 L *				
213 SHARES	BOONE COUNTY COAL CORP PFD V T C	SHARPLES W VA	12/28/26	12/21/34	13473 61	12765 09	708 52 L *				

MRS P F M JANNEY

AMOUNT	SECURITY	ADDRESS	DATE PURCHASED	DATE SOLD	COST	AMOUNT RECEIVED	TOTAL PROFIT OR LOSS	100% LESS THAN ONE YEAR	80% ONE TO TWO YEARS	60% TWO TO FIVE YEARS	40% FIVE TO TEN YEARS
2500 SHARES	R J REYNOLDS TOBACCO B	WINSTON-SALEM N C	1/20/33	12/26/34 TO 12/28/34	81000 00	123974 16	42974 16		42974 16		
$50000	LEHIGH POWER SEC 6% 2026	NEW YORK N Y	4/25/33	12/20/34	35000 00	45855 00	10855 00		10855 00		
500 SHARES	ELECTRIC STORAGE BATTERY	PHILADELPHIA PA	12/15/33	12/31/34	22500 00	23500 00	1000 00		1000 00		
500 SHARES	INSURANCE CO OF NORTH AMERICA	PHILADELPHIA PA	5/17/33	12/31/34 Janney	19745 21	27000 00	7254 79		7254 79		
2500 SHARES	STATE STREET INVESTMENT CORP	BOSTON MASS	5/29/33 TO 6/20/33	12/31/34	147500 00	161250 00	13750 00		13750 00		
594 5/100 SHARES	SUN OIL CO	PHILADELPHIA PA	11/21/33	12/31/34	27087 50	40989 45	13901 95		13901 95		
545 SHARES	SUN OIL CO	PHILADELPHIA PA	7/19/34 TO 7/25/34	12/31/34	31315 00	37605 00	6290 00	6290 00			
$3000	1500 WALNUT ST 1ST 6% CTF OF DEP	PHILADELPHIA PA	10/27/33 TO 12/29/33	12/31/34	2695 00	2160 00	535 00 L		535 00 L		
$11000	DO	DO	1/10/34 TO 1/25/34	12/31/34	3302 50	2640 00	662 50 L	662 50 L			
$30000	NEW ENGLAND POWER ASSN 5½% 1954	BOSTON MASS	5/10/33	12/31/34	27000 00	30500 00	3500 00		3500 00		
$50000	PHILA CO 5% 1967	PITTSBURGH PA	4/25/33 TO 5/1/33	12/31/34	36102 35	41000 00	4897 65		4897 65		
$100000	COM OF PENNA 4% OCT 1954	HARRISBURG PA	11/10/25	12/31/34	101690 92	117000 00	15309 08				15309 08
$50000	DELAWARE COUNTY 4 1/4%	DELAWARE COUNTY PA	5/13/32	12/31/34	50731 61	58500 00	7768 39			7768 39	
								5627 50	98711 86	12900 89 L	185822 00 L

W C JANNEY TRUSTEE FOR MRS F P M JANNEY

AMOUNT	SECURITY	ADDRESS	DATE PURCHASED	DATE SOLD	COST	AMOUNT RECEIVED	TOTAL PROFIT OR LOSS	100% LESS THAN ONE YEAR	80% ONE TO TWO YEARS	60% TWO TO FIVE YEARS	40% FIVE TO TEN YEARS
$30000	SOUTH BAY CONSOL WATER 1ST 5% 1950	NEW YORK N Y	12/15/33	10/25/34 TO 11/20/34	27617 50	30429 04	2811 54	2811 54			
500 SHARES	THIRD NATIONAL INVESTORS CORP	NEW YORK N Y	2/8/34 TO 2/16/34	7/12/34 TO 9/27/34	9400 00	7847 30	1552 70 L	1552 70 L			
1800 SHARES	FOURTH NATIONAL INVESTORS CORP	NEW YORK N Y	10/27/33 TO 2/1/34	8/21/34 TO 10/9/34	31700 00	29950 84	1749 16 L	1749 16 L			
$5000	1500 WALNUT ST 1ST 6% CTF OF DEP	PHILADELPHIA PA	10/27/33	10/18/34	1475 00	1235 50	239 50 L	239 50 L			
	TOTAL GAIN OR LOSS							4897 68	98711 86	12900 89 L	185822 00 L
								100%	80%	60%	40%
	PER CENT OF GAIN OR LOSS TAXABLE							4897 68	78969 48	7740 53 L	74328 80 L

* NOTE - THIS SALE MADE BY TAXPAYER TO PURCHASER A CORPORATION IN WHICH TAXPAYER OWNS OVER 50% OF STOCK HENCE NOT DEDUCTABLE UNDER SECTION 24 OF REVENUE ACT OF 1934

L - LOSS

SUMMARY

W C JANNEY	NET LOSS FOR RETURN	91963 35
MRS P F M JANNEY	NET GAIN FOR RETURN	94491 00
NET GAIN		2527 65

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35 Before United States Board of Tax Appeals

Docket No. 86849. Promulgated January 31, 1939

WALTER C. JANNEY AND PAULINE F. M. JANNEY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petitioners, husband and wife, filed a joint income tax return for the taxable year 1934. The wife had gains from the sale of capital assets which were taken into account in accordance with the provisions of section 117 (a), Revenue Act of 1934. The husband had losses from the sale of capital assets which were taken into account in accordance with the same section of the act. *Held*, that the amount of the husband's losses from the sale of capital assets which can be used as a deduction in computing the aggregate net income shown on the joint return is limited to $2,000 under the provisions of section 117 (d), Revenue Act of 1934, since the husband had no net gain from the sale of capital assets in 1934.

Bernhard Knollenberg, Esq., for the petitioners.
James D. Head, Jr., Esq., for the respondent.

Opinion

Rendered January 31, 1939

BLACK: The Commissioner has determined a deficiency in income tax against petitioners for the year 1934 of $37,109.29.

The petition assigns two errors, as follows:

36 (1) The respondent has erroneously disallowed a loss of $89,963.35 sustained by the petitioner, Walter C. Janney, upon the sale of capital assets during said year 1934, notwithstanding the inclusion in the petitioners' joint return for said year 1934 of gains from the sale of capital assets by the petitioner, Pauline F. M. Janney, in the amount of $94,491, in contravention of sections 51 (b) and 117 (d) of the Revenue Act of 1934.

(2) The respondent has erroneously attributed a capital loss of $729.82 (appearing in the petitioners' joint return as an item in arriving at a net income of $21,564.31 from the W. C. Janney trust) to the petitioner, Walter C. Janney, whereas in fact said W. C. Janney trust was created by the petitioner Pauline F. M. Janney and said capital loss should be attributed to her and allowed as a deduction against the capital gains of said petitioner, Pauline F. M. Janney, in any event.

A stipulation has been filed which disposes of issue (2) above in petitioners' favor. Effect will be given to this stipulation in a recomputation under Rule 50.

The facts in this proceeding have all been stipulated and we adopt them as our findings of fact. The following resume [1] of the facts will suffice for the purposes of this opinion:

The petitioners are husband and wife, residing at Bryn Mawr, Pennsylvania, and were living together throughout the year 1934. During the year 1934 the wife, Pauline F. M. Janney, realized gains from the sale of capital assets in the amount of $127,501.02. The amount of such gains to be taken into account under section 117 (a) of the Revenue Act of 1934 was $94,491. During the year 1934 the husband, Walter C. Janney, suffered losses from the sale of capital assets in the amount of $229,544.66, of which the amount to be taken into account under section 117 (a) of the Revenue Act of 1934 was $91,963.35.

37 The petitioners filed a single joint return for the year 1934 with the collector of internal revenue for the first district of Pennsylvania at Philadelphia, Pennsylvania. In this return the capital gains of the wife, in the amount of $94,491 as stated above, were included in gross income, and the capital losses of the husband in the amount of $91,963.35 were deducted in toto. The joint return showed a net income (including other items not concerned in this case) of $26,160.30, on which normal and surtaxes in the amount of $1,648.91 were computed.

In determining the deficiency the respondent, in accordance with the provisions of article 117-5 of Regulations 86, determined that the losses of petitioner Walter C. Janney from the sale of capital assets could not be applied to reduce the gains realized by petitioner Pauline F. M. Janney from the sale of capital assets. Accordingly, respondent refused to permit the losses of petitioner Walter C. Janney from the sale of capital assets in the amount of $91,963.35 to be offset against the gains from the sale of capital assets in the amount of $94,491 realized by petitioner Pauline F. M. Janney for the purpose of computing their net taxable income for the calendar year 1934, except to the extent of the $2,000 limitation provided for by section 117 (d) of the Revenue Act of 1934. By reason of such holding, respondent increased the capital gain reported by the petitioners on their joint return by an amount of $89,963.35.

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[1] See footnote on p. 25.

The applicable sections of the statute and the Treasury regulations promulgated in pursuance thereof are printed in the margin.[2] By a reading of article 117-5 of Regulations
38 86 it will be seen that the situation which we have in the instant case is specifically covered thereby.

It is well settled that regulations promulgated by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and pursuant to authority granted in the statute, have the force and effect of law if they are reasonable and are not in conflict with some express provision of the statute.
39 Maryland Casualty Co. v. United States (1920), 251 U. S. 342, 349, and cases there cited; United States v. Eliason (1842), 16 Pet. 291; Ex parte Reed (1879), 100 U. S. 13; In re Kollock (1897), 165 U. S. 526; Alfred E. Fuhlage (1935), 32 B. T. A. 222, 229.

The petitioners concede that the aforementioned regulation is applicable and that it sustains the action taken by the Commissioner in his determination of the deficiency, if it is valid. Petitioners contend that the regulation is invalid in that it puts an interpretation on the provisions of section 117 (d) of the Revenue Act of 1934 which is not justified by the language of that provision when read in conjunction with other provisions of the same revenue act. Petitioners' contention may be summarized to be briefly this: That in applying section 117 (d) to a joint

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[2] Revenue Act of 1934—

SEC. 51. INDIVIDUAL RETURNS.

* * * * * *

(b) Husband and Wife.—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

SEC. 117. CAPITAL GAINS AND LOSSES.

(d) Limitation on Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

Regulations 86—

ART. 51.—* * * A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable yea ris at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income in $5,000 or more, either each must make a return or the income of each must be included in a single joint return. * * * If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year * * *.

ART. 117-5. Application of section 117 in the case of husband and wife.—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

return filed by husband and wife it should be construed as if it read thus:

> In a joint return of husband and wife losses of both spouses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains of both spouses from such sales or exchanges.

When we consider that it is now well settled that although husband and wife may, under the permission granted them by law, file a joint return, they are nevertheless regarded as separate taxpayers, we think the construction of section 117 (d) for which petitioners contend is not admissible. A very similar contention was made in H. Denny Pierce et al., 37 B. T. A. 225, as to the construction of section 23 (r) (1) of the Revenue Act of 1932, but we denied it.

In the Pierce case husband and wife filed a joint income tax return. The husband realized profits in the taxable year from sales of securities held less than two years but sustained no losses from such sales. The wife sustained losses in the taxable year from such sales but realized no profits from like sales. We held that under section 23 (r) (1) of the Revenue Act of 1932 the wife could not deduct the loss from her gross income not
40 connected with the sale of securities held less than two
years; nor could the husband in a joint return offset the wife's loss against his profits from the sale of securities held less than two years.

Section 23 (r) (1) of the Revenue Act of 1932, which was involved in the Pierce case, reads as follows:

> (r) LIMITATION ON STOCK LOSSES.—
>
> (1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations) * * *.

While section 117 (d) of the Revenue Act of 1934, involved in the instant case, deals with the subject of "Limitation on Capital Losses," whereas section 23 (r) (1) of the Revenue Act of 1932 deals with the subject of "Limitation on Stock Losses" from the sale of securities held for less than two years, we can see no valid reason why a different construction should be given to section 117 (d) of the Revenue Act of 1934 in applying it to a joint return of husband and wife than that which we gave under similar circumstances to section 23 (r) (1) of the Revenue Act of 1932 in the Pierce case. Our decision in the Pierce case was recently affirmed by the Second Circuit in Pierce v. Commissioner, — Fed. (2d) —, (Dec. 12, 1938).

On the authority of the Pierce case, supra, we affirm the Commissioner in applying the provisions of section 117 (d) of the Revenue Act of 1934 to the joint return filed by petitioners.

Decision will be entered under Rule 50.

41 Before United States Board of Tax Appeals

Decision

Entered March 9, 1939

Pursuant to the opinion of the Board promulgated January 31, 1939, the respondent herein on February 23, 1939, filed a notice of settlement and proposed recomputation and the petitioner on March 3, 1939, having filed an acquiescence in said recomputation, it is

Ordered and decided that there is a deficiency in income tax for the year 1934 in the amount of $36,700.60.

(Sgd.) EUGENE BLACK, *Member.*

42 In United States Circuit Court of Appeals, for the Third Circuit

[Title omitted.]

Petition for review

Filed April 26, 1939

To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:

Now come Walter C. Janney and Pauline F. M. Janney by their attorneys, Bernhard Knollenberg and Harry J. Rudick, and hereby petition for a review of the determination of the United States Board of Tax Appeals promulgated in the above-entitled case on January 31, 1939, and of the final order and decision entered therein March 9, 1939, and respectfully show to this Honorable Court as follows:

I. Petitioners are individuals living together as husband and wife and were at all times during the calendar year 1934 and still are, residents and citizens of the United States, residing at Bryn Mawr, Pennsylvania, within the First District of Pennsylvania. Petitioners, on March 15, 1935, duly filed in accordance with Section 51 (b) of the Revenue Act of 1934 a joint income-tax return for the year 1934 with the Collector of Internal Revenue for the First District of Pennsylvania, whose office is located in the City of Philadelphia, County of Philadelphia,

and State of Pennsylvania, within the jurisdictional limits of the United States Circuit Court of Appeals for the Third Circuit.

43 II. The respondent on review (hereinafter referred to as the "Commissioner") is the duly qualified and acting Commissioner of Internal Revenue of the United States holding his office by virtue of the laws of the United States. The Commissioner determined a deficiency in petitioners' income tax for the calendar year 1934 as computed in the joint return filed by them pursuant to Section 51 (b) of the Revenue Act of 1934 in the amount of $37,109.29 and mailed to petitioners a notice of such deficiency dated July 28, 1936, in accordance with the provisions of Section 272 (a) of the Revenue Act of 1934. Thereafter on , 1936, petitioners filed with the United States Board of Tax Appeals a petition for the redetermination of such deficiency which received the docket number 86849.

Pursuant to the determination contained in its opinion promulgated January 31, 1939, and reported in 39 B. T. A. (No. 36), the Board of Tax Appeals made its final order and decision which was entered March 9, 1939, that the deficiency in the petitioners' income tax for the year 1934 was $36,700.60.

III. The nature of the controversy is as follows:

Petitioners in their joint income tax return for the year 1934, filed pursuant to Section 51 (b) of the Revenue Act of 1934, offset losses sustained by petitioner, Walter C. Janney, upon sales of capital assets (as defined in the Revenue Act of 1934) against gains realized by petitioner, Pauline F. M. Janney, upon sales of capital assets.

The percentage of such gains realized by petitioner, Pauline F. M. Janney, to be taken into account in computing net income under Section 117 (a) of the Revenue Act of 1934 was $94,491 and the percentage of such losses sustained by petitioner, Walter C. Janney, to be taken into account in computing net income under Section 117 (a) of the Revenue Act of 1934 was $91,963.35.

The Commissioner disallowed the deduction of the amount of such losses sustained by petitioner, Walter C. Janney, in
44 excess of the limit of $2000 provided in Section 117 (d) of the Revenue Act of 1934 and the effect of such disallowance was to increase petitioners' aggregate net income by $89,963.35, resulting in a deficiency in tax of $36,700.60.

Petitioners contended in their appeal to the Board of Tax Appeals that in computing their aggregate net income under Section 51 (b) of the Revenue Act of 1934 and other applicable sections of said act, losses sustained by petitioner, Walter C. Janney, upon sales of capital assets should be deducted from gains realized by petitioner, Pauline F. M. Janney, upon sales of capital assets

and that Article 117-5 of Reg. 86 is invalid in ruling that the limitation provided in Section 117 (d) of the Revenue Act of 1934 upon the allowance of losses of one spouse from sales or exchanges of capital assets should be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

The Board of Tax Appeals sustained the determination of the Commissioner and held that the amount of losses sustained by petitioner, Walter C. Janney, upon sales of capital assets to be taken into account in computing petitioner's aggregate net income for the year 1934 is limited to $2,000 under Section 117 (d) of the Revenue Act of 1934.

IV. Petitioners state that in the decision and final order of the Board of Tax Appeals manifest error occurred to petitioners' prejudice and assign the following errors:

1. The Board of Tax Appeals erred in deciding that the amount of losses sustained by petitioner, Walter C. Janney, upon sales of capital assets to be taken into account in computing petitioners' aggregate net income for the year 1934, is limited to $2,000 by the provisions of Section 117 (d) of the Revenue Act of 1934.

2. The Board of Tax Appeals erred in failing to decide that the amount of losses sustained by petitioner, Walter C. Janney, upon sales of capital assets to be taken into account
45 in computing petitioners' aggregate net income for the year 1934 under Section 51 (b) of the Revenue Act of 1934 and other applicable sections of said act was $91,963.35.

3. The Board of Tax Appeals erred in failing to decide that in computing the net income of husband and wife who have filed a joint income-tax return under Section 51 (a) of the Revenue Act of 1934, the aggregate losses of such husband and wife from sales or exchanges of capital assets should be deducted from the aggregate gains of such husband and wife upon sales or exchanges of capital assets and that the limitation provided in Section 117 (d) of the Revenue Act of 1934 upon the allowance of losses from sales or exchanges of capital assets should be applied to the aggregate net losses of such husband and wife.

4. The Board of Tax Appeals erred in failing to decide that Article 117-5 of Reg. 86 is invalid in ruling that the limitation provided in Section 117 (d) of the Revenue Act of 1934 upon the allowance of losses of one spouse from sales or exchanges of capital assets should be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

5. The Board of Tax Appeals erred in ordering and deciding that there is a deficiency in petitioners' income tax for the year 1934 in the amount of $36,700.60.

6. The Board of Tax Appeals erred in failing to order and decide that there is no deficiency in petitioners' income tax for the year 1934.

Wherefore, petitioners pray that the action of the Board of Tax Appeals in this case be reviewed by this Court; that the order and decision of the Board of Tax Appeals be reversed; that appropriate action be taken to the end that the errors complained of be reviewed and corrected by this Court; and that peti-
46 tioners be granted such other and further relief as may to said Court appear proper in the premises.

Respectfully submitted.

BERNHARD KNOLLENBERG,
HARRY J. RUDICK,
Counsel for Petitioners,
25 Broadway, New York, N. Y.

[*Duly sworn to by B. Knollenberg and H. J. Rudick; jurats omitted in printing.*]

48 In United States Circuit Court of Appeals

Proof of service

Filed April 29, 1939

SIR: Please take notice that the undersigned has this day filed with the United States Board of Tax Appeals on behalf of the petitioners in the above-entitled case, a petition for review by the United States Circuit Court of Appeals for the Third Circuit of the determination of the United States Board of Tax Appeals promulgated in the above-entitled case on January 31, 1939, and of the final order and decision entered therein on March 9, 1939. A copy of the petition for review and assignments of error as filed is attached hereto and served upon you.

Dated April 26, 1939.

HARRY J. RUDICK,
Counsel for Petitioners,
25 Broadway, New York, N. Y.

To COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

Service of a copy of the foregoing notice of filing, together with one copy of the petition for review and assignments of error, is acknowledged this twenty-sixth day of April 1939.

(Sgd.) J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Counsel for Respondent.

49 Before United States Board of Tax Appeals

Praecipe for record

Filed May 9, 1939

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the clerk of the United States Circuit Court of Appeals for the Third Circuit copies duly certified as correct of the following documents in the above-entitled case:

1. The docket entries of proceedings before the Board.
2. Pleadings before the Board.
3. Opinion and decision of the Board.
4. Stipulation of facts adopted as findings of fact by the Board.
5. Petition for review, together with notice of filing and proof of service.
6. This praecipe.

HARRY J. RUDICK,
Attorney for Petitioners,
25 Broadway, New York, N. Y.

Service of a copy of the foregoing praecipe is acknowledged this twenty-ninth day of April, 1939. No counter-praecipe will be filed.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue, Counsel for Respondent.

50 [Clerk's certificate to foregoing transcript omitted in printing.]

51 In United States Circuit Court of Appeals for the Third Circuit

No. 7130. October Term, 1939

WALTER C. JANNEY AND PAULINE F. M. JANNEY, PETITIONERS

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Minute entry of hearing

And afterwards, to wit, the 16th day of October 1939, come the parties aforesaid by their counsel aforesaid, and this case being

called for argument sur pleadings and briefs, before the Honorable Francis Biddle, Honorable Charles Alvin Jones, and Honorable Joseph Buffington, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 26th day of December 1939, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

52 In United States Circuit Court of Appeals for the Third Circuit

No. 7130. October Term, 1939

WALTER C. JANNEY AND PAULINE F. M. JANNEY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review From the United States Board of Tax Appeals

Opinion

Filed December 26, 1939

Before BIDDLE, JONES, and BUFFINGTON, Circuit Judges.

BIDDLE, Circuit Judge.

The petitioners were married and living together in 1934. Mrs. Janney realized gains and Mr. Janney losses in that year on the sale of capital assets. They filed a joint income-tax return in which the losses were used to offset the gains. Except to the extent of $2,000 the Commissioner of Internal Revenue disallowed all the losses, on the ground that the losses of one spouse could not be set off against the gains of the other. The Board of Tax Appeals sustained the Commissioner, and this appeal followed.

The statutory provisions involved are found in the Revenue Act of 1934. Section 51 (b)[3] provides:

"(b) Husband and wife.—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

[3] 26 U. S. C. A., § 51.

53 "(1) Each shall make such a return, or

"(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income."

Section 23 [4] of the act provides, with respect to capital losses:

"In computing net income there shall be allowed as deductions:

* * * * *

"(j) Capital losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d)."

The relevant part of Section 117 (d) [5] is as follows:

"Limitation on capital losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

The decision of the Board is supported by the authority of the Second, First, and Fourth Circuits, respectively, in Pierce v. Commissioner, 100 F. (2d) 397, 398; Sweet v. Commissioner,[6] 102 F. (2d) 103; and Nelson v. Commissioner, 104 F. (2d) 521, involving the construction of the Act of 1932, a similar statute.[7] Judge Learned Hand dissented vigorously in the Pierce case; and the two later decisions, noting the doubt without expanding the reasoning, followed the precedent of the majority.[8] In the Pierce case, Treasury Regulation 77, Art. 381, provided that where "the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions or credits to which either is entitled shall be taken from such

54 aggregate income." Section 23 (r) [9] of the Act of 1932, which was before the court, limited stock losses to "losses from sales or exchanges of stocks * * * which are not capital assets (i. e., held less than two years) * * * only to the extent of the gains from such sales or exchanges * * *." The majority reasoned that neither taxpayer, under this limitation, could take the deduction, since the wife had no gains, and the husband could not deduct the loss of another taxpayer. Judge Hand, accepting the Regulation, could find no preference for a

[4] 26 U. S. C. A. § 23.
[5] 26 U. S. C. A. § 101.
[6] Application for Certiorari denied, 52 S. Ct. 822. Certiorari was also denied in Demuth v. Commissioner. 100 F. (2d) 1012 (C. C. A. 2), 59 S. C. 822.
[7] Section 23 (r) of the Revenue Act of 1932.
[8] In the Sweet case the court said: "While the decision of the Court of Appeals for the Second Circuit may involve some doubt, we do not regard it as clearly wrong, and, being squarely in point, we follow it." In the Nelson case too the court felt constrained to recognize the impressiveness of the dissent. "While a majority of this Court are much impressed with the reasoning of Judge Learned Hand in his dissenting opinion in the Pierce case, the legal question involved is a close one and we feel that we should follow the decisions of the First and Second Circuits, particularly in view of the denials of certiorari by the Supreme Court."
[9] 26 U. S. C. A. § 23, Historical Note (r).

construction of the statute holding that this clause "imposes a condition upon the privilege, as opposed to a limitation upon its amount." He argued that when the Act required the tax to be computed on the net aggregate income it meant the balance after adding all the items of gross income and subtracting all deductions. The limit on stock losses would then "be the aggregate of 'non-capital' gains of both spouses, and to single out those of the spouse who has 'non-capital' losses is to trace into the account the several sources of the 'aggregate income,' which is precisely what the account need not, and should not, do."

With this reasoning we agree. Other allowable deductions in excess of gross income of one spouse may be deducted from the net income of the other, for otherwise there would be no point in filing a joint return. Thus the right to file the joint return involves the necessity of disregarding the source from which the deduction is derived. The Government suggests that husband and wife cannot be regarded as a joint entity—have not been by the cases construing tax statutes. But that seems to us unconvincing in considering whether a statute authorizing a
55 single return for both does not also contemplate a consolidation of the losses and gains of both, a more rational and more direct construction of a statute evidently intended by Congress to be in favor of the taxpayer.[10] Since the statute provides that in the case of a joint return "the tax shall be computed on the aggregate income" it logically and indeed necessarily follows, in the absence of an express statutory provision to the contrary, that in arriving at joint net income both gross income and deductions of the spouses must be aggregated and treated as the income and deductions of a single taxpayer.

We must now consider the effect of Regulation 86, Art. 117–5, promulgated under the Act of 1934. This article is as follows:

"Application of section 117 in the case of husband and wife.—In the application of section 117 a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets."

Prior to the promulgation of Art. 117–5, Art. 381 had been in effect, unchanged, for many years, and had been sanctioned by the reenactment of a number of statutes, including the Act of 1934. The Commissioner of Internal Revenue had, on December 29, 1932, when the question was submitted to him, expressed the

[10] See Commissioner v. Thomas, 84 F. (2d) 562, 563 (C. C. A. 5): "Section 51 (permitting husband and wife to file a joint return) is clearly intended by Congress to be in favor of the taxpayer."

opinion that "the loss sustained by the husband would offset the same amount of gain realized by the wife from such source." [11] Therefore, up until the time when Art. 117-5 was issued, we have a construction by the Commissioner in favor of the taxpayer, in accordance with Judge Hand's view of the meaning of
56 the Act and of Art. 381. The Commissioner now takes
the position that his former opinion is "informal" and inconsistent with the new regulation. It is not, of course, a treasury regulation and does not have the validity or effect of a regulation. Helvering v. New York Trust Co., 292 U. S. 455, 468; Biddle v. Commissioner, 302 U. S. 573, 582. But it is a treasury interpretation of the meaning of the statute, an interpretation which is altered in the new regulation. We think that Art. 117-5 is not a construction warranted by the words of the section permitting the joint return, words which, in our opinion, are unambiguous and clear from substantial doubt.

In coming to this conclusion we have considered the rule of law which holds that in interpreting a statute we should give great weight to the administrative construction of the law where, after a ruling has been prescribed, the section of the statute to which it applies is enacted in the same words. The Commissioner argues that the text of Art. 117-5 was included in the regulations issued under the Revenue Acts of 1936 and 1938, and that a provision limiting the deduction of capital losses was reenacted in both of these acts, showing legislative approval of the regulations. But Section 51 (b) was not reenacted in 1938. The section was changed to read: "(b) Husband and wife.—In the case of a husband and wife living together the income of each (even though one has no gross income) may be included in a single return made by them jointly, in which case the tax shall be computed on the aggregate income, and the liability with respect to the tax shall be joint and several. No joint return may be made if either the husband or wife is a non-resident alien." The construction, therefore, expressed in Art. 117-5 "was neither uniform, general, nor long-continued * * *." Iselin v. U. S., 270 U. S. 245, 251. In most of the cases where the rule has been invoked the administrative act has been approved by successive enactments without change, and emphasis is laid, in the application of the rule, on the extended continuity of the construc-
57 tion New Haven R. R. Co. v. Interstate Commerce Com-
mission, 200 U. S. 361, 401; Copper Queen Mining Co. v. Arizona Board, 206 U. S. 474, 479; Helvering v. Winmill, 305 U. S. 79, 83.[12]

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[11] C. C. H. Fed. Tax Ser. 1933, 111, Par. 6037.

[12] An exception is found in Hassett v. Welch, 303 U. S. 303, 312, where an amendment to the Federal Estate Tax was passed in 1931, and had been construed by a treasury regulation in 1932, and reenacted in 1933.

But administrative regulations are not conclusive, but are at most decisions which can be changed, and afford to the courts in the ultimate test nothing more than persuasive rules of construction. It has never been said that administrative action removes the statute from the field of judicial construction. As Judge Learned Hand remarked, in F. W. Woolworth Co. v. United States, 91 F. (2d) 973, 976: "At most, administrative practice is a weight in the scale, to be considered, but not to be inevitably followed * * * to suppose that Congress must particularly correct each mistaken construction under penalty of incorporating it into the fabric of the statute appears to us unwarranted; our fiscal legislation is detailed and specific enough already. While we are of course bound to weigh seriously such rulings, they are never conclusive * * *." If this were not so, regulations stratified by the "sanction" of law would lose all requisite flexibility. The principle "does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by re-enactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers."[18]

The decision of the Board of Tax Appeals is reversed, and the case is remanded for further proceedings in conformity with this opinion.

A true Copy:

Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

58 In United States Circuit Court of Appeals for the Third Circuit

No. 7130. October Term, 1939

WALTER C. JANNEY AND PAULINE F. M. JANNEY, PETITIONERS

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

(Filed Dec. 26, 1939)

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

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[18] Helvering v. Wilshire Oil Co., Inc. — U. S. —, decided November 6, 1939.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby reversed, and the cause is remanded to the said Board of Tax Appeals for further proceedings in conformity with the opinion of this court.

Philadelphia, December 26, 1940.

FRANCIS BIDDLE,
Circuit Judge.

[File endorsement omitted.]

59 [Clerk's certificate to foregoing transcript omitted in printing.]

60 Supreme Court of the United States

Order allowing certiorari

(Filed April 29, 1940)

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Roberts took no part in the consideration and decision of this application.

Endorsement on cover: File No. 44250. U. S. Circuit Court of Appeals, Third Circuit. Term No. 843. Guy T. Helvering, Commissioner of Internal Revenue, petitioner vs. Walter C. Janney and Pauline F. M. Janney. Petition for a writ of certiorari and exhibit thereto. Filed March 26, 1940. Term No. 843 O. T. 1939.

U. S. GOVERNMENT PRINTING OFFICE: 1940

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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 113

CHESTER GAINES AND THERESA GAINES, HUSBAND AND WIFE, PETITIONERS,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MAY 29, 1940.

CERTIORARI GRANTED OCTOBER 14, 1940.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 113

CHESTER GAINES AND THERESA GAINES, HUSBAND AND WIFE, PETITIONERS,

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INDEX.

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., NOVEMBER 5, 1940.

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Docket Entries.

Docket No. 93,806. 1

Chester Gaines and Theresa Gaines,
Husband and Wife,
Petitioners,

v.

Commissioner of Internal Revenue,
Respondent.

2

Appearances:

For Taxpayer: Frank E. Karelsen, Jr., Esq.

For Commissioner: Conway Kitchen, Esq.

1938

May 25—Petition received and filed. Taxpayer notified. (Fee paid.)

May 25—Copy of petition served on General Counsel.

June 16—Answer filed by General Counsel.

June 16—Request for Circuit hearing in New York City filed by General Counsel. 3

June 21—Notice issue placing proceeding on New York, N. Y. calendar. Answer and request served.

1939

Apr. 10—Hearing set May 22, 1939, at New York City.

May 22—Hearing had before Mr. Sternhagen on merits. Submitted. Stipulation of facts filed. Briefs due June 15, 1939.

June 1—Transcript of hearing of May 22, 1939, filed.

June 5—Brief filed by General Counsel.

June 15—Brief filed by taxpayer. June 16, 1939, copy served.

June 26—Memorandum opinion rendered John M. Sternhagen, Division 10. Decision will be entered for the respondent.

June 26—Decision entered, J. M. Sternhagen, Division 10.

Sept. 20—Petition for review by United States Circuit Court of Appeals (Second) with assignments of error filed by taxpayer.

Sept. 20—Proof of service filed by taxpayer.

Oct. 6—Praecipe for record filed by taxpayer with proof of service thereon.

5 Oct. 23—Amended Praecipe filed by taxpayer with proof of service thereon.

Petition.

(Filed May 25, 1938.)

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 93,806.

[SAME TITLE]

6

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:A:1 LHC-90D) dated February 28, 1938, and as a basis of their proceeding allege as follows:

1. The petitioners are individuals, and during the calendar year 1934 were married and living together as husband and wife. They reside at 1130 Park Avenue, New York City, N. Y.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioners on February 28, 1938.

3. The taxes in controversy are income taxes for the calendar year 1934, and for $5,008.55.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

The addition of $18,031.59 to the income reported on the return of petitioners for the calendar year 1934, which addition is set forth under item marked (a) on pages 1 to 4 of said notice of deficiency, a copy of which is annexed hereto and marked Exhibit A. The foregoing addition is based upon the erroneous theory that capital
losses of a wife may not be deducted from capital gains 8
of a husband upon a joint return filed for the calendar year 1934, and that the wife is entitled to deduct only $2,000. of her capital losses in excess of her capital gains.

5. The facts upon which the petitioners rely as the basis of their proceeding are as follows:

(a) During the entire calendar year 1934, the petitioners were married and living together as husband and wife.

(b) During the calendar year 1934, Chester Gaines sold
stocks which had been held by him for less than one year 9
and derived from such sales a gain of $18,466.41.

(c) During the calendar year 1934, Theresa Gaines sold stocks which resulted in gains or losses to her as follows:

Gains from sales of stocks held one year or less	$2,987.94
Gains from sales of stocks held over ten years	220.96
Losses from stocks held two to five years	37,091.63
Losses from stocks held five to ten years	2,077.13

(d) The stock sold by Theresa Gaines and Chester Gaines, referred to in paragraphs (b) and (c) above, were capital assets, as defined under Section 117 and other applicable sections of the Revenue Act of 1934, as amended.

(e) The petitioners filed a single joint income tax return for the calendar year 1934 reporting therein their aggregate income in accordance with the provisions of Section 51 of the Revenue Act of 1934, as amended.

11 (f) The gain to Chester Gaines, recognized upon the sales of the foregoing stock, amounted to $18,466.42. The net loss to Theresa Gaines, recognized upon the sales of the foregoing stock, amounted to $20,031.60. The difference of $1,565.18 was deducted as capital loss on the joint return filed by the petitioners for the year 1934. The joint income of the petitioners on said return, aside from the foregoing stock sales, exceeded the foregoing deduction of $1,565.18.

WHEREFORE, the petitioners pray that this Board may
12 hear the proceeding and rule that the determination of a deficiency of $5,008.55 and the income tax liability of the petitioners for the calendar year 1934 is erroneous, and that no deficiency whatever exists with respect thereto.

(s) FRANK E. KARELSEN, JR.,
Counsel for Petitioners,
Office & P. O. Address,
% Karelsen & Karelsen,
230 Park Avenue,
Borough of Manhattan,
City of New York.

State of New York, } ss.:
County of New York, }

Chester Gaines, being duly sworn, says that he is one of the petitioners above named; that he has read the foregoing petition or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

Chester Gaines. 14

Subscribed and sworn to before me
this 24th day of May, 1938.

Sadie Scherr,
Notary Public, Kings County,
Kings Co. Clk's No. 894, Reg. No. 9202,
N. Y. Co. Clk's No. 1203, Reg. No. 9S813,
Bronx Co. Reg. No. 293S39,
Queens Co. Reg. No. 7132, Clk's No. 1876,
Nassau Co. Clk's No. 9547,
Term Expires March 30, 1939. 15

(Seal)

State of New York, } ss.:
County of New York, }

Theresa Gaines, being duly sworn, says that she is one of the petitioners above named; that she has read the foregoing petition or had the same read to her, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to

be upon information and belief, and those facts she believes to be true.

THERESA GAINES.

Subscribed and sworn to before me
this 23rd day of May, 1938.

SADIE SCHERR,
Notary Public, Kings County,
Kings Co. Clk's No. 894, Reg. No. 9202,
N. Y. Co. Clk's No. 1203, Reg. No. 9S813,
17 Bronx Co. Reg. No. 293S39,
Queens Co. Reg. No. 7132, Clk's No. 1876,
Nassau Co. Clk's No. 9S47,
Term Expires March 30, 1939.

(Seal)

Exhibit A, Annexed to Petition.

1091M SN-N

Feb 28 1938

18 IT:A:1
LHC-90D

Mr. Chester Gaines and
Mrs. Theresa Gaines, Husband and Wife,
One Wall Street,
New York, New York.

Sir and Madam:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1934, discloses a deficiency of $5,008.55, as shown in the statement attached.

 19

In accordance with section 272(a) of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C.,
for the attention of IT:Cl:P-7. The signing and filing of 20
this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By (Signed) CHAS. T. RUSSELL, 21
Deputy Commissioner.

Enclosures:

Statement
Form 870

LHC/FB-2

STATEMENT.

IT:A:1

LHC-90D

Mr. Chester Gaines and
Mrs. Theresa Gaines,
Husband and Wife,
One Wall Street,
23 New York, New York.

Tax Liability for Taxable Year Ended December 31, 1934

	Liability	Assessed	Deficiency
Income Tax	$9,247.81	$4,239.26	$5,008.55

In making this determination of your income tax liability, careful consideration has been given to the internal revenue agent's report dated May 28, 1936; to your protest executed July 13, 1936; to the statements made at the conference held on September 18, 1936, in the office of the internal revenue agent in charge at 615 Federal
24 Office Building, 90 Church Street, New York, New York; to the protest dated January 24, 1938, signed by Frank E. Karelsen, Jr., your representative, and to the statements made at the conference held in the Bureau on January 28, 1938.

A copy of this letter and statement has been mailed to your representative, Frank E. Karelsen, Jr., 230 Park Avenue, New York, New York, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Adjustments to Net Income

Net income reported on the return	$34,594.80
Unallowable deductions and additional income:	
(a) Loss claimed by Theresa Gaines from the sale of securities in excess of the limitation as provided by section 117(d) of the Revenue Act of 1934 on deductions for capital losses as recognized by the provisions of section 117(a)	18,031.59
	$52,626.39 26
(b) Dividends received from the Dominion Stores, Ltd., and the McIntyre Porcupine Mines, Ltd., transferred from item 10(a) of the return to item 10(c), the space provided for reporting such dividends	279.07
Total	$52,905.46
Nontaxable income and additional deduction:	
(c) Dividends received from the Dominion Stores, Ltd., and the McIntyre Porcupine Mines, Ltd., transferred from item 10(a) of the return to item 10(c), the space provided for reporting such dividends 27	279.07
Net income as adjusted	$52,626.39

Explanation of Adjustments

(a) Careful consideration has been given to your contention that since the income of a husband and wife may be included in a single joint return and the tax computed

on the aggregate income in accordance with the provisions of section 51(b)(2) of the Revenue Act of 1934, there is nothing in the Act to uphold article 117-5 of Regulations 86 relating to the income tax under the Revenue Act of 1934.

This office holds that the loss of $35,959.86 sustained by Mrs. Gaines from the sale of securities as computed under section 111 and recognized under section 112 of the Revenue Act of 1934 and taken into account by her only to the extent of $20,031.59 as provided by section 117(a),
29 is subject to the limitation on deductions for capital losses under section 117(d), that is, such losses "shall be allowed as deductions only to the extent of $2,000.00 plus the gains from such sales and exchanges."

Attention is invited to the provisions of article 117-5, appearing on page 218 of Regulations 86 relating to the income tax under the Revenue Act of 1934:

> "*Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be
> 30 separate taxpayers. Accordingly, the limitation under section 117(d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets."

Note also income tax ruling 2868, published in Internal Revenue Bulletin, Cumulative Bulletin XIV-1, pages 111-112, January, 1935, to June, 1935:

> "Where a joint return is filed and the wife takes into account under section 117(a) of the Revenue Act of 1934 a loss of $7,000.00 in excess of gains or sales

of capital assets, she is limited to a deduction of $2,000.00 under section 117(d) of that Act. Where the wife's income from other sources was only $400.00, the balance of the deductible loss amounting to $1,600.00 may be applied against the net income of the husband in computing the combined net income of the husband and wife in the joint return. (See T. D. 4511, page 107.)"

The following headnotes of the decisions of the United States Board of Tax Appeals in the cases of H. Denny
Pierce and Alma C. Pierce, and Robert H. Montgomery 32
and Lois C. Montgomery, published in United States Board of Tax Appeals Reports, Volume 37, No. 34 and No. 35, promulgated January 28, 1938, and February 1, 1938, respectively, sustain the provisions of article 117-5:

"Husband and wife filed a joint income tax return. The husband realized profits in the taxable year from sales of securities held less than two years but sustained no losses from such sales. The wife sustained losses in the taxable year from such sales but realized no profits from like sales. *Held,* under section
23(r)(1) Revenue Act of 1932, the wife cannot de- 33
duct the loss from her gross income, nor can the husband, in a joint return, offset the wife's loss against his profits."

* * * * *

"1. In applying the limitation on stock losses provided for in section 23(r)(1), Revenue Act of 1932, in a case where husband and wife file a single joint return, it is *held* that the losses of one spouse who had no gain from the sale or exchange of similar securities may not be used to offset the gains of the other."

(b) and (c) A review of your books of account and records disclosed that you received dividends of $29.07

and $250.00 from the Dominion Stores, Ltd., and the McIntyre Porcupine Mines, Ltd., respectively, and that these dividends were included in item 10(a) of the return, whereas they should have been reported in item 10(c). These dividends have accordingly been transferred from item 10(a) to item 10(c), the space provided on the return for reporting dividends received from foreign corporations.

Computation of Tax

35

Net income as adjusted		$52,626.39
Less:		
Credit for personal exemption	$2,500.00	
Credit for two dependents	800.00	3,300.00
Surtax net income		$49,326.39
Less:		
Dividends ($4,600.47—$279.07)	$4,321.40	
Earned income credit (10% of $11,528.87)	1,152.89	5,474.29
Net income subject to normal tax		$43,852.10
Normal tax at 4% on $43,852.10		$ 1,754.08
Surtax on $49,326.39		7,518.13
Total income tax liability		$ 9,272.21
Less:		
Income tax paid at the source		24.40
Correct income tax liability		$ 9,247.81

36

Brought forward	$ 9,247.81
Income tax assessed:	
Account #200333	4,239.26
Deficiency in income tax	$ 5,008.55

LHC/FB-2

Answer. 38

(Filed June 16, 1938.)

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 93,806.

[SAME TITLE]

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named petitioners, filed May 25, 1938, admits and denies as follows: 39

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.
4. Denies that the respondent erred as alleged in paragraph 4 of the petition.

5(a), (b). Admits the allegations contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

(c). Denies the allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) . Admits the allegations contained in subparagraph (d) of paragraph 5 of the petition.

(e). Admits that a joint income tax return was filed by the petitioners for the taxable year 1934.

(f). Admits the allegations contained in the first sentence of subparagraph (f) of paragraph 5 of the petition
41 but denies all other allegations contained in said subparagraph.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the determination of the respondent be in all things confirmed.

(Signed) J. P. WENCHEL,
J. P. WENCHEL,
Chief Counsel,
42 Bureau of Internal Revenue.

Of Counsel:

CONWAY N. KITCHEN,
Special Attorney,
Bureau of Internal Revenue.

Memorandum Opinion. 43

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 93,806.

[SAME TITLE]

Frank E. Karelsen, Jr., Esq., for the Petitioners.

Conway Kitchen, Esq., for the Respondent.

Sternhagen: The Commissioner determined a deficiency
of $5,008.55 in petitioners' income tax for 1934 in part
by adding to the jointly reported income of husband and 44
wife a capital gain of the husband. The facts are stipulated. Petitioners contend that this gain may be offset by capital losses of the wife within the limitations of section 117(d), Revenue Act of 1934. The identical question was considered in *Walter C. Janney,* 39 B. T. A. 240 (on review C. C. A. 3), and decided contrary to petitioners' contention. For earlier years the same question arising under the similar section 23(r)(1), Revenue Act of 1932, the Second Circuit Court of Appeals, in *Pierce* v. *Commissioner,* 100 Fed. (2d) 397; *Demuth* v. *Commissioner,* 100 Fed. (2d) 1012, certiorari denied ——U. S. —— (May 2,
1939), and the First Circuit Court of Appeals in *Sweet* v. 45
Commissioner, 102 Fed. (2d) 103, certiorari denied —— U. S. —— (May 1, 1939), reached the same conclusion. These decisions have just been followed by the Circuit Court of Appeals for the Fourth Circuit in *Nelson* v. *Commissioner,* —— Fed. (2d) —— (June 12, 1939). In accordance with those decisions.

Enter:

Entered June 26, 1939.

Decision will be entered for the respondent.

(Seal)

46

Decision.

UNITED STATES BOARD OF TAX APPEALS

WASHINGTON.

DOCKET No. 93,806.

[SAME TITLE]

In accordance with the Board's Memorandum Opinion, entered June 26, 1939, it is

47 ORDERED and DECIDED that there is a deficiency of $5,008.55 in petitioners' income tax for 1934.

Enter:
Entered June 26, 1939.

(Signed) J. M. STERNHAGEN,
Member.

Petition for Review.

(Filed September 20, 1939.)

48 UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 93,806.

[SAME TITLE]

TO THE HONORABLE JUDGES OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT:

CHESTER GAINES and THERESA GAINES, the petitioners, by FRANK E. KARELSEN, JR., their attorney, feeling themselves aggrieved by the decision and order made and entered in this cause, hereby petition for a review of the decision and order by the United States Circuit Court

of Appeals for the Second Circuit for the reasons specified in the assignments of error which are filed herein and made a part hereof, and respectfully show:

I—The petitioners are individuals and citizens of the
United States, and during the calendar year 1934 were
married and living together as husband and wife, at 1130
Park Avenue, City and State of New York. For the
calendar year 1934, the petitioners filed a joint federal
income tax return with the Collector of Internal Revenue
for the Third District of New York within the time 50
required by law.

II—The respondent determined a deficiency in income
taxes for the calendar year 1934 against the petitioners
herein in the sum of $5,008.55. In accordance with the
provisions of the Revenue Act of 1934, respondent sent
to the petitioners by registered mail, a notice of said deficiency.
Thereafter, the petitioners filed an appeal from
the said notice of deficiency with the United States Board
of Tax Appeals. On June 26, 1939, the Board entered its
decision and final order and determination wherein and
whereby the Board ordered and decided the amount of 51
the deficiency against the petitioners for the said calendar
year to be in the amount determined by the respondent.

III—During the calendar year 1934, Chester Gaines sold securities which were capital assets as defined in Section 117 of the Revenue Act of 1934, and which had been held by him for less than one year, and he derived from such sales a recognized capital gain of $18,466.41, the entire amount of which was required to be taken into account under Section 117 (a) of such Act. During the calendar year 1934, Theresa Gaines sold securities which were capital assets as defined in Section 117 of the Revenue Act of 1934, resulting in recognized and accountable capital gains or losses to her as follows:

Time Held	Profit or (loss)	Per cent	Gain or (loss) taken into account under Sec. 117(a) of the Revenue Act of 1934.
1 year or less	$ 2,987.94	100	$ 2,987.94
2 to 5 years	(37,091.63)	60	(22,254.97)
5 to 10 years	(2,077.13)	40	(830.85)
Over 10 years	220.96	30	66.29
	($35,959.86)		($20,031.59)

53 On their joint return or the calendar year 1934, the petitioners offset the said gain of Chester Gaines, amounting to $18,466.41, against the said loss of Theresa Gaines, amounting to $20,031.59, claiming a net deduction of $1,565.18 by reason thereof.

IV—The respondent determined that the limitation imposed by Section 117 (d) of the Revenue Act of 1934 should be applied separately to each of the petitioners and allowed Theresa Gaines to deduct only $2,000. in excess of the amount of her gains taken into account, instead of said amount of $20,031.59, which petitioners had
54 deducted. Accordingly, respondent added the amount of $18,031.59 to petitioners' net income.

V—The Board of Tax Appeals sustained the respondent. It held that the excess of Theresa Gaines' capital losses taken into account over her capital gains taken into account could not be deducted from the capital gain of Chester Gaines, except to the extent of $2,000.

VI—The issue in the proceeding before the Board was as follows:

Could the petitioners in their joint return filed for 1934 deduct the entire excess of Theresa Gaines' recognized and accountable capital losses over her recognized

and accountable capital gains for that year, namely $20,031.59, from the recognized and accountable gain of her husband, Chester Gaines, for the same year, namely $18,466.41, thereby producing a net deduction of $1,565.18.

VII—Petitioners assert that in the record and proceed-
ings before the Board and in the decision and final order
of determination rendered and entered by the Board
manifest error occurred and intervened to the prejudice
of the petitioners, and the petitioners assign the following
errors, each of which they aver occurred in the record,
proceedings, decision and final order of determination and 56
upon which they rely to reverse the said decision and
final order of determination so rendered and ordered by
the Board, to wit:

Assignments of Error.

The petitioners assign as error the following acts and omissions of the Board of Tax Appeals:

I—The order and decision that there should be in-
cluded in the income of the petitioners the sum of $18,-
466.41, being the recognized and accountable capital gain
realized by Chester Gaines, without allowing the deduc- 57
tion of the entire sum of $20,031.59, instead of only $2,000.
thereof, said sum of $20,031.59 being the excess of Theresa
Gaines' recognized and accountable capital losses over her
recognized and accountable capital gains.

II—The order and decision that there should be included in the income of the petitioners the sum of $16,466.41, being Chester Gaines' recognized and accountable capital gain of $18,466.41 less $2,000. of the excess of the recognized and accountable capital losses of Theresa Gaines over her recognized and accountable capital gains.

III—The order and decision that the petitioners should not be allowed in computing their net income to deduct

the sum of $1,565.18, being the amount of Theresa Gaines' recognized and accountable capital losses in excess of her recognized and accountable capital gains, namely $20,-031.59, less Chester Gaines' recognized and accountable capital gain of $18,466.41.

IV—The order and decision that the excess of the recognized and accountable capital losses of Theresa Gaines over her recognized and accountable capital gains, namely $20,031.59, could not be deducted, except to the extent of $2,000. thereof, from the recognized and accountable
59 capital gain of Chester Gaines, namely $18,466.41, to produce a net deduction of $1,565.18 in the joint return filed by the petitioners.

V—The order and decision that the limitation contained in Section 117(d) of the Revenue Act of 1934 is to be applied separately to husband and wife when a joint return is filed.

VI—The failure to determine that under Sections 23(e) and 51(b) of the Revenue Act of 1934 the petitioners are entitled to deduct the recognized and accountable capital losses of one spouse from the recognized and accountable
60 capital gains of the other spouse, and that the only effect of Sections 23(j) and 117(d) of such Act is to limit to a sum of $2,000. the deductibility of the excess of such capital losses over such capital gains.

VII—The order and determination that there is a deficiency of $5,008.55 in the petitioners' income tax for 1934 and the failure to determine that the amount of income tax paid by petitioners for said year constituted the total tax due from them for said year.

WHEREFORE the petitioners petition that the decision and order of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit, and that a transcript of record be prepared

in accordance with the law and with the rules of the said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by the said Court, and that the decision and order of the Board of Tax Appeals be reversed.

Respectfully submitted,

(S) Frank E. Karelsen, Jr.,
Counsel for Petitioners,
230 Park Avenue, 62
New York City, N. Y.

State of New York, }
County of New York, } ss.:

Frank E. Karelsen, Jr., being duly sworn, deposes and says that he is the attorney of record of the petitioners above named; and as such, is duly authorized to verify the above and foregoing petition for review to the United States Circuit Court of Appeals for the Second Circuit; that he has read the said petition for review and is familiar with the statements therein contained and that the facts stated are true, except as to those facts stated to 63
be upon information and belief and those facts he believes to be true.

Frank E. Karelsen, Jr.

Sworn to before me this
19th day of September, 1939.

Sadie Scherr,
Notary Public, Kings County,
Kings Co. Clk's No. 850, Reg. No. 1122,
N. Y. Co. Clk's No. 959, Reg. No. 1S600,
Bronx Co. Reg. No. 286-S-41,
Queens Co. Reg. No. 6739, Clerk's No. 1730,
Nassau Co. Clk's No. 42-S-41,
Term Expires March 30, 1941.

(Seal)

64 **Notice of Filing Petition for Review.**

(Filed September 20, 1939.)

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 93,806.

[SAME TITLE]

To:

65 J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

You are hereby notified that under date of September 20, 1939, a petition to have the decision of the Board of Tax Appeals in the above cause reviewed by the United States Circuit Court of Appeals for the Second Circuit was filed with the said Board of Tax Appeals. A copy of the petition for review is hereby served upon you.

66 (Signed) FRANK E. KARELSEN, JR.,
FRANK E. KARELSEN, JR.,
230 Park Avenue,
New York, N. Y.

Service of a copy of the foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 20th day of September, 1939.

(Signed) J. P. WENCHEL,
J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Stipulation of Facts. 67

(Filed May 22, 1939.)

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 93,806.

[SAME TITLE]

It is hereby stipulated and agreed by and between the parties to this proceeding that the following facts may be regarded as having been proved by proper evidence, without prejudice to the right of either party to introduce 68
other competent evidence not inconsistent with the facts herein stipulated:

1. The petitioners are individuals and citizens of the United States and during the calendar year 1934 were married and living together as husband and wife, at 1130 Park Avenue, City and State of New York. For the calendar year 1934, the petitioners filed a joint Federal income tax return with the Collector of Internal Revenue for the Third District of New York within the time required by law.

2. During the calendar year 1934, Chester Gaines sold 69
shares of stock of corporations, which had been held by him for less than one year, and he derived from such sales a recognized capital gain of $18,466.41.

3. During the calendar year 1934, Theresa Gaines sold shares of stock of corporations, resulting in capital gains or losses to her as follows:

Time Held	Profit or (loss)	Per cent	Taxable Gain or (loss)
1 year or less	$ 2,987.94	100	$ 2,987.94
2 to 5 years	(37,091.63)	60	(22,254.97)
5 to 10 years	(2,077.13)	40	(830.85)
Over 10 years	220.96	30	66.29
	($35,959.86)		($20,031.59)

4. The shares of stock sold by the petitioners, referred to in Paragraphs "2" and "3" above, were capital assets, as defined in Section 117 of the Revenue Act of 1934.

5. On their joint return for the calendar year 1934, the petitioners claimed a capital loss deduction of $1,565.18 which was arrived at by offsetting the said gain of Chester Gaines amounting to $18,466.41 against the said loss of Theresa Gaines amounting to $20,031.59. Said
71 joint return reported a net income of $34,594.80, on which the petitioners computed normal and surtaxes of $4,239.26.

6. In his statutory notice of deficiency, the respondent determined that Theresa Gaines was limited to a deductible loss of $2,000., plus the gains derived by her in 1934 from said sales of stock, and taken into account under the provisions of Section 117 of the Revenue Act of 1934. Accordingly, the amount of $18,031.59 was added in the deficiency notice to the petitioners' net income as reported on their joint return.

72 7. The foregoing stipulations of facts are not to be construed as an admission by the respondent that the excess of the aforesaid losses of Theresa Gaines over the aforesaid gains of Chester Gaines is allowable as a deduction in computing net income subject to tax on the joint return of the petitioners for the calendar year 1934.

(Sgd.) Frank E. Karelsen, Jr.,
Counsel for Petitioners.

(Sgd.) J. P. Wenchel,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Amended Praecipe. 73

(Filed October 23, 1939.)

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 93,806.

[SAME TITLE]

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, copies duly certified as correct, of the following documents and records in the above-entitled proceeding in connection with the petition for review by the said United States Circuit Court of Appeals for the Second Circuit heretofore filed by the petitioners herein: 74

1. Docket entries of proceedings before the Board.
2. Petition.
3. Answer.
4. Memorandum opinion of the Board of Tax Appeals.
5. Order and decision of the Board.
6. Petition for review filed by the petitioners, together with proof of notice of filing same. 75
7. The stipulation of facts.
8. This praecipe.

(S) Frank E. Karelsen, Jr.,
Attorney for Petitioners,
230 Park Avenue,
New York, N. Y.

Service of a copy of the foregoing Praecipe is hereby acknowledged this 19th day of October, 1939.

J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

76

Clerk's Certificate.

UNITED STATES BOARD OF TAX APPEALS,

WASHINGTON.

DOCKET No. 93,806.

CHESTER GAINES and THERESA GAINES,
Husband and Wife,
77 Petitioners,
v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

I, B. D. GAMBLE, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 26, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in
78 my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 1st day of November, 1939.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

(Seal)

[fol. 27] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1939

No. 247

(Argued April 10, 1940. Decided April 22, 1940.)

CHESTER GAINES and THERESA GAINES, Petitioners,
against
GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

On petition to review an order of the Board of Tax Appeals assessing against the petitioners a deficiency in their income taxes for the year 1934.

Before L. Hand, Augustus N. Hand and Patterson, Circuit Judges

Frederick Baum for the petitioners.
Maurice J. Mahoney for the respondent.

Per CURIAM:

Order affirmed upon the authority of Pierce v. Helvering, 100 F. (2d) 397 (C. C. A. 2).

[fol. 28] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 8th day of May one thousand nine hundred and forty.

Present Hon. Learned Hand, Hon. Augustus N. Hand, Hon. Robert P. Patterson, Circuit Judges

CHESTER GAINES and THERESA GAINES, Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WALTER C. JANNEY AND PAULINE F. M. JANNEY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Attorney General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above cause on December 26, 1939, reversing the decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 35–40) is reported in 39 B. T. A. 240. The opinion of the Circuit Court of Appeals (R. 51–55) is reported in 108 F. (2d) 564.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

D. E. Roberts, Clerk.

[fol. 29] [Endorsed:] United States Circuit Court of Appeals, Second Circuit, Chester Gaines and Theresa Gaines, v. Commissioner of Int. Revenue. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed May 8, 1940. D. E. Roberts, Clerk.

[fol. 30] United States of America,
Southern District of New York:

I, D. E. Roberts, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 29, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Chester Gaines and Theresa Gaines, Petitioners, against Commissioner of Internal Revenue, Respondent, as the same remain of record and on file in my office.

In Testimony Whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 8th day of May, in the year of our Lord one thousand nine hundred and forty, and of the Independence of the said United States the one hundred and sixty-fourth.

D. E. Roberts, Clerk. (Seal.)

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 14, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is assigned for argument immediately following No. 36.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Roberts took no part in the consideration and decision of this application.

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CITATIONS

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 26, 1939. (R. 55.)[1] The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether Section 117 (d) of the Revenue Act of 1934 permits losses sustained by the husband from the sale of capital assets to be deducted to the extent of the wife's gains from similar sales where a joint return is filed.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations will be found in the Appendix, *infra*, pp. 9–12.

STATEMENT

The facts as stipulated (R. 14–34) and as found by the Board of Tax Appeals (R. 35–37) are substantially as follows:

The taxpayers are husband and wife, residing at Bryn Mawr, Pennsylvania, and were living together throughout the year 1934. (R. 14, 36.)

During that year the wife, Pauline F. M. Janney, realized gains from the sale of capital assets in the amount of $127,501.02. The amount of such gains

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[1] Through error the date of the judgment is given as December 26, 1940, but the Clerk's endorsement shows that the judgment was entered and filed on December 26, 1939.

to be taken into account under Section 117 (a) of the Revenue Act of 1934 was $94,491. During the year 1934 the husband, Walter C. Janney, suffered losses from the sale of capital assets in the amount of $229,544.66, of which the amount to be taken into account under Section 117 (a) of the Revenue Act of 1934 was $91,963.35. (R. 14–16, 36.)

The taxpayers filed a joint return for the year 1934. In the return the capital gains of the wife in the amount of $94,491 were included in gross income and the capital losses of the husband in the amount of $91,963.35 were deducted. (R. 17, 37.)

In auditing the return the Commissioner refused to permit the losses sustained by the husband to be offset against the gains realized by the wife and on the basis of that disallowance and of another adjustment not here involved determined a deficiency of $37,109.29. (R. 9, 35.) The Board of Tax Appeals sustained the Commissioner's determination as to the disallowance of the loss claimed under Section 117 (a) and determined a deficiency of $36,700.60. (R. 40, 41.) The Circuit Court of Appeals reversed the Board.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Section 117 (d) of the Revenue Act of 1934, either alone or in conjunction with Section 51 (b) (2), permits losses sustained by one spouse on the sale of capital assets to be applied against the gains of the other spouse from similar sales, provided a joint return is filed.

2. In not holding that under Section 117 (d) and Section 51 (b) (2) a loss sustained on the sale of capital assets by one spouse is deductible only to the extent of his or her gains from similar sales (plus $2,000), even though a joint return is filed.

3. In not holding that the deductions which may be entered in the joint return are those to which each spouse, separately considered, is entitled.

4. In not holding that regulations promulgated under Section 51 (b) (2) and Section 117 (d) of the Revenue Act of 1934 were valid regulations which controlled the disposition of this case.

5. In holding that Article 117–5 of Regulations 86 is inconsistent with Section 51 (b) (2) of the Revenue Act of 1934 and invalid.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in substantial conflict with the decisions of the Circuit Court of Appeals for the Second Circuit in *Pierce* v. *Commissioner,* 100 F. (2d) 397, and *Demuth* v. *Commissioner,* 100 F. (2d) 1012, certiorari denied, 307 U. S. 627, with the decision of the Circuit Court of Appeals for the First Circuit in *Sweet* v. *Commissioner,* 102 F. (2d) 103, certiorari denied, 307 U. S. 627, and with the decision of the Circuit Court of Appeals for the Fourth Circuit in *Nelson* v. *Commissioner,* 104 F. (2d) 521. Those cases involved Section 23 (r) of the Revenue Act of 1932 which allowed losses upon sale of securities constituting noncapital assets only to the extent of gains from

similar sales, and in those cases the courts held that the filing of a joint return did not authorize one spouse to apply such losses against the gains of the other.

The present case involves cognate provisions in Section 117 (d) of the Revenue Act of 1934 which limit losses upon sale of capital assets to the extent of capital gains plus $2,000. And in ruling that the capital losses of one spouse could be applied against the capital gains of the other, the court below recognized that it was departing from the holdings of the *Pierce, Demuth, Sweet,* and *Nelson* cases (R. 52–53).

2. This case presents an important question in the administration of the federal income tax laws because the court below has held invalid an applicable treasury regulation, and has failed to give effect to another, each of which requires a contrary result here.

(a) Article 117–5 of Regulations 86, promulgated under the Revenue Act of 1934, unambiguously provides:

> In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

The regulations issued under subsequent revenue acts reach substantially the same result. See Article 117–5 of Regulations 94 (1936 Act); Article 117–5 of Regulations 101 (1938 Act); Section 19.117–5 of Regulations 103 (Int. Rev. Code). The court below specifically declared these provisions invalid.[2] (R. 53–54.) It is, therefore, essential to the orderly administration of the statute to have an authoritative determination of whether these provisions run afoul of the statute.

(b) Moreover, the court below has failed to give effect to Article 51–1 of Regulations 86 (Appendix, *infra,* p. 10), which provides that if the spouses file a joint return, the tax is computed on the aggregate income, and "all deductions and credits to which *either* is entitled shall be taken from such aggregate income." [Italics supplied.] These provisions

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[2] In refusing to follow Article 117–5 of Regulations 86, the court below noted that Section 51 (b) was amended in 1938, and thought that this indicated an intention of Congress not to approve these regulations (R. 54). There are, however, two conclusive answers to any argument based upon the 1938 modification of Section 51 (b):

First, the 1938 modification was directed at a wholly different question and left the present question untouched. The change in 1938 was intended merely to impose joint and several liability upon the spouses in the *collection* of the tax, thus remedying the loophole thought to be present in preexisting law in such cases as *Cole* v. *Commissioner*, 81 F. (2d) 485 (C. C. A. 9th), and *Crowe* v. *Commissioner*, 86 F. (2d) 796 (C. C. A. 7th).

Second, in any event, Article 117–5 was in effect in 1936 when Congress reenacted the applicable provisions without disapproving the administrative construction under the 1934 Act, here involved. Cf. *Hassett* v. *Welch*, 303 U. S. 303.

had been in effect for many years,[3] and were regarded as applicable in the *Pierce* decision. 100 F. (2d) at 398. In accordance with the familiar rule, the repeated reenactment of the statutory provisions should be taken as evidencing legislative approval of these regulations.[4]

Under these regulations, the deductions to which either spouse is entitled may be taken against their consolidated income in a joint return. And even though one spouse has no income to absorb his or her deduction, that deduction is nevertheless available to offset the income of the other. In other words, the filing of a joint return may increase the availability of a deduction, *but it cannot serve to create a deduction which would not otherwise have been allowable.* See *Gummey* v. *Commissioner,* 26 B. T. A. 894. Here, the very question in issue is whether Mr. Janney was entitled to the claimed deduction, and we submit that under Section 117 (d), there was no deduction which he could have taken. The decision below, in effect, requires both spouses to be treated as a single person where a joint return is filed. Such result is not only in conflict with the regulations but is contrary to the implications of such cases as *Van Vleck* v. *Commissioner,* 80 F. (2d) 217 (C. C. A. 2d), certiorari denied, 298 U. S,

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[3] See Article 401 of Regulations 65 and 69, promulgated under the Revenue Acts of 1924 and 1926, respectively; Article 381 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932, respectively.

[4] Cf., e. g., *Helvering* v. *Winmill,* 305 U. S. 79.

656[5] (net loss carry-over of one spouse may not be applied against income of the other).

CONCLUSION

In view of the conflict of decisions and the general importance of the question presented, it is respectfully submitted that the petition should be granted.

ROBERT H. JACKSON,
Attorney General.

MARCH, 1940.

[5] Compare the decisions holding that where one spouse sells property to another, the loss (in the absence of any statute prohibiting the deduction) may be deductible in their joint return. *Commissioner* v. *Thomas*, 84 F. (2d) 562 (C. C. A. 5th); *Commissioner* v. *Brumder*, 82 F. (2d) 944 (C. C. A. 7th); *Hill* v. *United States*, 12 F. Supp. 798 (C. Cls).

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:—

*   *   *   *   *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

*   *   *   *   *

(U. S. C., Title 26, Sec. 23.)

SEC. 51. INDIVIDUAL RETURNS.

*   *   *   *   *

(b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

*   *   *   *   *

(U. S. C., Title 26, Sec. 51.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation, and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

(U. S. C., Title 26, Sec. 101.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 51-1. *Individual returns.*—For each taxable year every single person and every

married person not living with husband or wife for any part of the taxable year, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is $1,000 or over, must make a return of income. Every married person living with husband or wife for any part of the taxable year, but not at the close of the taxable year, must make a return if his gross income for the taxable year is $5,000 or more, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family). (See article 25–7.) A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together at the close of the taxable year but not during the entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as the head of a family). (See article 25–7.) If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only

if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year.

* * * * *

ART. 117–5. *Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

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No. [illegible]

In the Supreme Court of the United States

October Term, 1940

[illegible] Helvering, Commissioner of Internal Revenue, [illegible]

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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 36

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WALTER C. JANNEY AND PAULINE F. M. JANNEY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 23–27) is reported in 39 B. T. A. 240. The opinion of the Circuit Court of Appeals (R. 32–36) is reported in 108 F. (2d) 564.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 26, 1939 (R. 36–37).[1] The petition for a writ of certiorari was filed March 26,

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[1] The date of the judgment is erroneously given in one place (R. 37) as December 26, 1940.

1940, and was granted April 29, 1940 (R. 37). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under the Revenue Act of 1934, the filing of a joint return permits the husband's capital losses to be deducted from his wife's capital gains.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Revenue Act of 1934 and of the regulations promulgated thereunder will be found in the Appendix, *infra,* pp. 34–37.

STATEMENT

The stipulation of facts (R. 8–22), adopted by the Board of Tax Appeals as its findings (R. 24) may be summarized as follows:

The respondents are husband and wife and reside at Bryn Mawr, Pennsylvania (R. 8). During 1934 the wife, Pauline F. M. Janney, realized net gains from the sale of capital assets in the sum of \$126,303.52. The amount of such gains to be taken into account under Section 117 (a) of the Revenue Act of 1934 (set out in the Appendix) was \$94,491. During 1934 the husband, Walter C. Janney, realized net losses from the sale of capital asests in the sum of \$220,687.06, of which the amount to be taken into account under Section

117 (a) of the Revenue Act of 1934 was $91,963.35 (R. 8–9).[2]

The respondents filed a single joint income tax return for the year 1934 (R. 8). In this return they reported a capital gain of $2,527.65, which represented the difference between the wife's adjusted capital gains ($94,491) and the husband's adjusted capital losses ($91,963.35) (R. 9–10, 13).

In auditing the return the Commissioner held, in accordance with Article 117–5 of Regulations 86, that the losses sustained by the husband could not be applied to reduce the gains realized by the wife and that the husband's losses accordingly could be deducted only to the extent of his own gains plus $2,000 (R. 10). By reason of this holding the Commissioner increased the capital gain reported by respondents by $89,963.35 (R. 10). On the basis of this adjustment, and of another adjustment not here involved, the Commissioner determined a deficiency of $37,109.29 (R. 5–6).

The Board of Tax Appeals sustained the Commissioner's decision on the capital loss issue and

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[2] The sum of $126,303.52 represents Mrs. Janney's capital gains less her own capital losses (R. 9). The sum of $220,687.06 represents Mr. Janney's capital losses less his own capital gains (R. 9). The item of $94,491 stated to represent the percentage of Mrs. Janney's capital gains which may be taken into account and the item of $91,963.35 stated to represent the percentage of Mr. Janney's losses to be taken into account are based on these net gains and net losses.

determined a deficiency of $36,700.60 (R. 27). The Circuit Court of Appeals reversed the Board (R. 37). This Court granted certiorari (R. 37).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Section 117 (d) of the Revenue Act of 1934, either alone or in conjunction with Section 51 (b) (2), permits losses sustained by one spouse on the sale of capital assets to be applied against the gains of the other spouse from similar sales, if a joint return is filed.

2. In not holding that under Section 117 (d) and Section 51 (b) (2) a loss sustained on the sale of capital assets by one spouse is deductible only to the extent of his or her gains from similar sales (plus $2,000), even though a joint return is filed.

3. In not holding that the deductions which may be entered in a joint return are those to which each spouse, separately considered, is entitled.

4. In not holding that regulations promulgated under Section 51 (b) (2) and Section 117 (d) of the Revenue Act of 1934 were valid regulations which controlled the disposition of this case.

5. In holding that Article 117-5 of Regulations 86 is inconsistent with Section 51 (b) (2) of the Revenue Act of 1934 and is invalid.

SUMMARY OF ARGUMENT

Sections 23 (j) and 117 (d) of the Revenue Act of 1934 together provide that losses from the sale

of capital assets shall be allowed as deductions only to the extent of $2,000 plus gains from such sales. Section 51 (b) permits a husband and wife to make a single joint return, in which case the tax shall be computed on the aggregate income.

It is the Government's position that even if a joint return is made the husband's capital losses can be deducted only to the extent of his own capital gains, and that gains of the wife cannot augment the deduction for the husband's losses. Deductions in a joint return may not be computed as if the husband and wife were one person. Whatever doubt might attend this question if the statute stood alone is eliminated, we submit, by the administrative construction, which has been impliedly approved by Congress.

1. With the exception of the decision below, the Government's position has been uniformly sustained by the courts. *Pierce* v. *Commissioner,* 100 F. (2d) 397 (C. C. A. 2d); *Demuth* v. *Commissioner,* 100 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 307 U. S. 627; *Sweet* v. *Commissioner,* 102 F. (2d) 103 (C. C. A. 1st), certiorari denied, 307 U. S. 627; *Nelson* v. *Commissioner,* 104 F. (2d) 521 (C. C. A. 4th); *Gaines* v. *Helvering,* 111 F. (2d) 144 (C. C. A. 2d), pending on petition for certiorari, No. 113, this Term. And compare *Taft* v. *Helvering,* 111 F. (2d) 145 (C. C. A.

2d), pending on petition for certiorari, No. 183, this Term.

2. The provision in Section 51 (b) that if a joint return is made the tax shall be computed on the aggregate income contemplates that a husband and wife may, in such a return, utilize all deductions which would be allowable to either separately, including deductions of one spouse in excess of that spouse's gross income. But it carries no inference that if a joint return is made these deductions are to be determined as if the husband and wife were one person. Deductions are to be computed as in any other case, and the aggregate net income is then to be ascertained by combining the separate items of income and the separate deductions of each spouse.

Statutory limitations upon the allowance of a deduction which are contingent upon the amount or kinds of income of the taxpayer should not be abridged by treating husband and wife as a single taxpayer if they elect to file a joint return. There is no general principle that husband and wife are to be treated as a single taxpayer for purposes of deductions if they file a joint return. Instead the cases have regarded them as separate taxpayers in computing deductions, except as Congress has specifically provided otherwise. *Van Vleck* v. *Commissioner,* 80 F. (2d) 217 (C. C. A. 2d), certiorari denied, 298 U. S. 656; *Commissioner* v. *Thomas,* 84 F. (2d) 562 (C. C. A. 5th);

Commissioner v. *Brumder,* 82 F. (2d) 944 (C. C. A. 7th).

3. Whatever doubt might attend the meaning of the Act if it stood alone it resolved by the administrative construction which has been tacitly approved by Congress. Ever since 1921 the Treasury has taken the general position that even in a joint return only those deductions can be taken "to which either spouse is entitled." Article 401 of Regulations 62. Under Section 23 (r) (1) of the 1932 Act, the predecessor of Section 117 (d) of the 1934 Act, the Bureau of Internal Revenue ruled that securities losses sustained by the wife might not be offset against securities gains of the husband, even though a joint return was filed. G. C. M. 15438, Cum. Bull, XIV-2, p. 156. And Article 117-5 of Regulations 86, promulgated under the Revenue Act of 1934 and explicatory of Section 117 (d) of that Act, explicitly provides that the limitation "on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets." *This regulation unequivocally covers the question here at issue.* The interpretation given Section 117 (d) of the 1934 Act by this regulation received tacit Congressional approval through the enactment of identical statutory provisions in the Revenue Act of 1936 and of analogous provisions in the Revenue Acts of 1938 and 1939.

ARGUMENT

The Filing of a Joint Return Does Not, Under the Revenue Act of 1934, Permit the Husband's Capital Losses to be Deducted From His Wife's Capital Gains

Section 23 (j) of the Revenue Act of 1934 provides that losses from sales or exchanges of capital assets shall be allowed as deductions only to the extent provided in Section 117 (d). Section 117 (d) provides: "Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges." Section 51 (b) of the Act permits a husband and wife to make a single joint return "in which case the tax shall be computed on the aggregate income."

The two respondents in the present case are husband and wife and they filed a joint return for 1934. During that year the husband realized net losses of $220,687.06 from the sale of capital assets, of which $91,963.35 was to be taken into account in computing net income under Section 117 (a) of the Revenue Act of 1934.[3] During the same

[3] Section 117 (a) of the Revenue Act of 1934 (set out in the Appendix) provides that in the case of a taxpayer other than a corporation only certain enumerated percentages of the gain or loss recognized upon the sale or exchange of capital assets shall be taken into account in computing net income, the percentages being graduated downward according to the length of time for which the capital assets have been held.

period the wife realized net gains of $126,303.52 from the sale of capital assets, of which $94,491 was to be taken into account under Section 117 (a).

The court below held that the husband's net losses from the sale of capital assets might be deducted in the joint return to the extent of the wife's net gains from similar sales. It said that the provision of Section 51 (b) that if a joint return is used the "tax shall be computed on the aggregate income" necessarily means "that in arriving at joint net income both gross income and deductions of the spouses must be aggregated and treated as the income and deductions of a single taxpayer." (R. 34).

It is the Government's position that the husband's capital losses could be deducted only to the extent of his own capital gains plus $2,000, and that the gains of the wife could not be used to augment the permissible deduction for the husband's losses. It is, of course, admitted that if the spouses had made separate returns each could deduct his or her capital losses only to the extent of his or her capital gains. And we think that nothing in the statutory provision permitting a joint return implies that deductions are to be computed in such a return as if the husband and wife were one person. On the contrary, we think that deductions are to be determined separately for each spouse, and that their aggregate net income is then to be ascertained by combining their separate items of income and their separate deductions.

If, however, the statute is ambiguous, that ambiguity is resolved by the administrative construction, tacitly approved by Congress, in favor of the interpretation which we here urge. Article 117–5 of Regulations 86, promulgated under the Revenue Act of 1934, explicitly and admittedly covers the present case. This regulation was presumptively valid when issued. It has since been approved by Congress, by its reenactment in the Revenue Act of 1936 of statutory provisions identical with those of the 1934 Act on which the regulation was based, and by its enactment of analagous provisions in the Revenue Acts of 1938 and 1939.

1. *The Decisions.*—With the single exception of the decision below in the present case, the position here taken by the Government has been uniformly upheld by the lower courts.[4] Substantially the same question which is here presented was resolved in favor of the Government in *Pierce* v. Commissioner, 100 F. (2d) 397 (C. C. A. 2d) That case has since been followed in *Demuth* v. *Commissioner,* 100 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 307 U. S. 627; *Sweet* v. *Commissioner,* 102 F. (2d) 103 (C. C. A. 1st), certiorari denied, 307 U. S. 627; *Nelson* v. *Commissioner,* 104 F. (2d) 521 (C. C. A. 4th); and *Gaines* v. *Helvering,* 111 F.

[4] The decision below is commented upon and criticized adversely in (1940) 49 Yale L. J. 1279, and in (1940) 53 Harv. L. Rev. 681.

(2d) 144 (C. C. A. 2d), pending on petition for certiorari, No. 113, this Term. The *Gaines* case, like the case at bar, was decided under the Revenue Act of 1934. The other cases involved the cognate provisions of the Revenue Act of 1932. Section 23 (r) (1) of that Act provided that losses from sales or exchanges of stocks and bonds which were not capital assets should be allowed only to the extent of gains from such sales or exchanges, and Section 101 (c) (8) defined "capital assets" as property held by the taxpayer for more than two years. In each of those cases the courts held that the losses of one spouse from the sale of non-capital assets could not be deducted from the gains of the other spouse from similar sales, even though a joint return was used. The court below recognized that these cases support the Government's position, but declined to follow them (R. 33).[5]

Since the decision below, the Circuit Court of Appeals for the Second Circuit has held *per curiam,* upon the authority of its decision in the *Pierce* case, that the limitation on the deduction for charities to 15 percent of the taxpayer's net income (Section 23 (o) of the Revenue Act of 1934)

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[5] The Board of Tax Appeals also has consistently upheld the Government's position. *Pierce* v. *Commissioner*, 37 B. T. A. 225; *Montgomery* v. *Commissioner*, 37 B. T. A. 232; *Sweet* v. *Commissioner*, decided June 30, 1938, memorandum opinion, unreported; *Demuth* v. *Commissioner*, decided February 7, 1938, memorandum opinion, unreported.

must be computed with reference to the husband's and wife's separate net incomes, and may not, even though a joint return is filed, be computed on their combined net income. *Taft* v. *Helvering,* 111 F. (2d) 145, pending on petition for certiorari, No. 183, this Term.

2. *Meaning of the Act.*—The decision below in the present case relies largely upon the reasoning of Judge Learned Hand's dissent in the *Pierce* case. Both the opinion below and that of Judge Hand rest their rejection of the Government's position, not on any construction of Section 117 (d) in the present case or of Section 23 (r) (1) of the 1932 Act in the *Pierce* case, but on their interpretation of Section 51 (b). In his dissent in the *Pierce* case Judge Hand asserted that the privilege given by Section 51 (b) of filing a joint return was based upon disregarding the source of the deductions and of the items of income. 100 F. (2d) at 398, 399. The court below approved this reasoning, and similarly concluded that the provision that if a joint return is made the tax shall be computed on the aggregate income necessarily means that both gross income and deductions of the spouses be "treated as the income and deductions of a single taxpayer." (R. 341.)

This argument fails, we think, to distinguish between the undisputed proposition that the allowable deductions of both spouses are to be con-

solidated in a joint return, and the further proposition, here at issue, that the two spouses are to be regarded as a single taxpayer or as one person in determining what deductions are allowable in such a return. It overlooks, in other words, the fundamental distinction between "pooling" the deductions and items of income of the two spouses in a joint return and treating the two spouses as one person for the purpose of ascertaining what items of income and what deductions are to be entered in that return. If the capital losses of Mr. Janney in 1934 had been deductible in full, without limitation, those losses could have been pooled in the joint return with any other deductions allowable to Mr. Janney or to his wife, and their aggregate sum could have been deducted from the aggregate income of the two in determining their taxable net income. But Mr. Janney's capital losses were not deductible in full, without limitation. By Section 117 (d) the deduction was specifically limited to $2,000 plus capital gains. Section 51 (b) provides that if a joint return is filed the tax shall be computed on the aggregate income. But nothing in this provision suggests that the making of a joint return expands the measure of the deduction under Section 117 (d) to embrace the capital gains of both spouses.

The provision of Section 51 (b) in question has to do with the computation of the tax on the joint

return and not with determining what items of income should be reported, or what deductions are allowable, or the amount of permissible deductions. It unquestionably contemplates that a husband and wife may, in a joint return, use all deductions which would be allowable to either separately, including deductions of one spouse in excess of that spouse's gross income.[6] But it carries no inference that because a joint return is employed these deductions are to be determined as if the husband and wife were one person. On the contrary, it is most unlikely that Congress intended by Section 51 (b) to provide for different limitations

[6] The provisions of Section 51 (b) of the Revenue Act of 1934 were first enacted in that form in Section 223 of the Revenue Act of 1921, and were contained also in the various intervening revenue acts. The Revenue Act of 1918, Section 223, provided for the filing of joint returns but did not specify how the tax was to be computed if a joint return was filed. In Sol. Op. 90, Cum. Bull. No. 4, p. 236 (1921), the Solicitor of Internal Revenue ruled that under the 1918 Act the tax of a husband and wife filing a joint return was to be computed on their net aggregate income, and that the deductions of one spouse, if they exceeded his or her income, could be deducted from the gross income of the other. Apparently, however, some doubt existed as to right of taxpayers having income subject to surtaxes to file joint returns and have their tax computed in this fashion, and it was to resolve this doubt that there was inserted in the 1921 Act the provision that in joint returns the tax should be computed on the aggregate income. See S. Rep. No. 275, 67th Cong., 1st Sess., p. 17; H. Rep. No. 350, 67th Cong., 1st Sess., p. 13; Hearings before the Senate Committee on Finance on H. R. 8245, 67th Cong., 1st Sess., p. 74.

on the allowance of deductions depending upon whether joint or several returns were made. Rather the implication is that deductions are to be determined as in any other case and that the aggregate net income is then to be ascertained by combining the separate items of income and the separate deductions of each spouse. In other words, two calculations are required for determining the tax. The first is the calculation, which would be necessary in any return, of the separate items of income and the separate deductions. Section 51 (b) has no reference to this first calculation. It merely provides that after this calculation has been made, the items of income and the deductions of the husband and those of the wife are to be combined and the tax calculated on the aggregate net income thus determined. There is nothing in the phrase "aggregate income" to suggest that a husband and wife are to be considered as one person in determining what deductions are allowable, and it has never before been construed as prescribing such a rule, either by the courts, by the Board of Tax Appeals, or by the Treasury Department regulations.

Statutory limitations upon deductions which are contingent upon the amount or kinds of income of the taxpayer should not be curtailed by permitting husband and wife to elect to be treated as a single taxpayer by filing a joint return. There can be no question that such a con-

struction of the revenue act would in considerable part defeat such limitations upon deductions. For example, the statutory limitation here involved, Section 117 (d), provides that capital losses shall be offset only against capital gains, except that capital losses are deductible unconditionally up to $2,000. The operation of this limitation would be substantially curtailed if capital losses could be offset against capital gains of either spouse, since the two would be likelier to have capital gains than the spouse who suffered the losses would be alone. Again, the statutory provision involved in the *Taft* case, Section 23 (o), limits deductions for charitable contributions to 15 percent of the taxpayer's net income. This limitation, too, would be relaxed if a husband and wife making a joint return were treated as a single taxpayer, since the combined net income of husband and wife would normally exceed the individual income of the spouse making the contributions. Situations can be conceived with respect to both of these statutory limitations on deductions in which the single taxpayer theory urged by the Government would be advantageous to the taxpayer, and the contentions urged by respondents disadvantageous.[7] But, on

[7] Section 117 (d) allows a deduction of $2,000 of capital loss from ordinary income, which would in some situations render advantageous to taxpayers the interpretation here urged by the Government. Thus, if both husband and wife had large capital losses and no capital gains, they could, under the separate taxpayer theory which we urge, each

the whole, the construction here urged by the Government is that calculated to give full effect to such statutory limitations on deductions and thus to produce maximum revenue. See (1940) 49 Yale L. J. 1279, 1284.

In the court below respondents argued, in effect, that to allow capital losses of one spouse to be offset against capital gains of the other spouse would not be inconsistent with the purpose of Section 117 (d). Specifically they pointed out that the legislative history both of Section 117 (d) of the 1934 Act and of its predecessor, Section 23 (r) (1) of the 1932 Act, shows that the purpose of Congress was to prevent taxpayers from escaping taxation on their ordinary incomes, that is on income from salaries, rents, dividends, etc., by utilization of deductions for security losses. See S. Rep. No. 665, 72d Cong., 1st Sess., p. 17; H. Rep. No. 704, p. 10, 73d Cong., 2d Sess., p. 10. And respondents argued that since to permit security losses of one spouse to be offset against security gains of the other spouse would

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take a $2,000 deduction, while under the theory of respondents but one $2,000 deduction would be allowable for both if a joint return were filed. See (1940) 49 Yale L. J. 1279, 1282. The spouses would still, however, have the option of filing separate returns.

Similarly, in the case of the limitation of charitable deductions to 15 percent of net income, the construction urged by respondents would be advantageous to the Government if one of the two spouses had no net income, *i. e.*, had deductions in excess of gross income. But there, too, the taxpayers would still have the option of filing separate returns.

not enable them to escape taxation on their ordinary incomes, Congress cannot have intended to prohibit such offsets.

This argument, carried to its logical conclusion, would permit capital losses sustained by one spouse to be offset against capital gains of the other spouse regardless of whether separate or joint returns were made. Moreover, while the basic purpose of Congress was doubtless to prevent security losses from being applied against ordinary income (except up to $2,000), Congress did not relieve capital gains from taxation, except as capital losses were available under the statute to offset them. And the normal reach of the tax on capital gains would be curtailed if husband and wife, by filing a joint return, could offset the capital losses of both against the capital gains of either.

There is no general principle that husband and wife are to be treated as a single taxpayer for purposes of deductions if they elect to file a joint return. "Even if they file joint returns, husband and wife apparently do not blend into a single taxpayer, at least for the purpose of the deduction provisions." Paul and Havens, *Husband and Wife under the Income Tax* (1936), 5 Brooklyn L. Rev. 241, 257.

Thus net losses sustained by the husband in a year in which he filed a separate return may not be carried over and deducted from the income of the wife in a joint return for the following year. *Van*

Vleck v. *Commissioner,* 80 F. (2d) 217 (C. C. A. 2d), certiorari denied, 298 U. S. 656. The court said (80 F. (2d) at 218), "Although the petitioners filed a joint return in 1930, each of them remained a separate and distinct taxpayer." Compare *Woolford Realty Co.* v. *Rose,* 286 U. S. 319.

Similarly, it was formerly held that losses sustained by one spouse in a bona fide sale of securities to the other spouse could be deducted in a joint return. *Commissioner* v. *Thomas,* 84 F. (2d) 562 (C. C. A. 5th); *Joseph E. Uihlein,* 30 B. T. A. 399, affirmed *sub nom. Commissioner* v. *Brumder,* 82 F. (2d) 944 (C. C. A. 7th); *Hill* v. *United States,* 12 F. Supp. 798 (C. Cls.); *Frank B. Gummey,* 26 B. T. A. 894; I. T. 2824 XIII–2 Cum. Bull. 293, overruling I. T. 1997, III–1 Cum. Bull. 149. Section 24 (b) (1) of the Internal Revenue Code, derived from Section 24 (b) (1) of the Revenue Act of 1938, now prohibits deductions for losses resulting from sales between members of a family, but this provision was adopted merely to prevent tax evasion. See H. Rep. No. 704, 73d Cong., 2d Sess., p. 23; 1939–1 Cum. Bull. 554, 571; 78 Cong. Rec. 2662. See also (1940) 53 Harv. L. Rev. 681, 682. It prohibits the deductions in question without reference to whether separate or joint returns are filed; clear proof that it carries no general inference that husband and wife are to be treated as a single taxpayer if they make a joint return. See (1940) 49 Yale L. J. 1279, 1283.

Formerly, also, some courts refused to hold spouses jointly and severally liable for the tax even though they filed a joint return. *Cole* v. *Commissioner,* 81 F. (2d) 485, 487 (C. C. A. 9th); *Crowe* v. *Commissioner* 86 F. (2d) 796 (C. C. A. 7th). The doubt engendered by these decisions was eliminated by the insertion in Section 51 (b) of the 1938 Act of a provision explicitly making liability with respect to the tax joint and several. Here too, however, the reason for the change was merely administrative expediency and not any theory that husband and wife are one taxpayer. See H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 29–30; (1940) 49 Yale L. J. 1279, 1284. And see *infra,* pp. 31–32.

Section 51 (b), we have sought to show, carries no inference that spouses filing a joint return are to be treated as a single taxpayer for the purpose of computing limitations on deductions. And since husband and wife are not required to make a joint return the privileges stemming from the option to do so should not be increased beyond the apparent intention of Congress. If, however, it is thought that the general congressional policy to favor the family unit, embodied in Section 51 (c) and in the larger personal exemption accorded married taxpayers, encompasses the issue at bar, that policy conflicts with the specific congressional intention, expressed in Section 117 (d), stringently

to limit deductions for capital losses. "* * * the policy of mitigating the tax burden of the family as an economic unit might be balanced against that of limiting deductions to those specifically allowed." (1940) 53 Harv. L. Rev. 681, 682. This statutory ambiguity, or conflict of policies, if there be such, is appropriate for solution by administrative construction. Below respondents asserted no more than that the relevant provisions of the Act are ambiguous, and, standing alone, are compatible with either the construction urged by respondents or that urged by the Government.

3. *The administrative construction.*—Article 51-1 of Regulations 86, promulgated under the Revenue Act of 1934, and explicatory of Section 51 of that Act, reads:

> If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income.

This provision is ultimately derived from Article 401 of Regulations 62, promulgated under the Revenue Act of 1921 (Section 223), which has been preserved in substance in succeeding regulations.[8]

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[8] See Article 401 of Regulations 65 and 69, promulgated, respectively, under the Revenue Acts of 1924 and 1926 (Section 223 of those Acts); Article 381 of Regulations 74 and 77, promulgated, respectively, under the Revenue Acts of 1928 and 1932 (Section 51 of those Acts); Article 51-1 of

As has been stated, Section 117 (d) of the Revenue Act of 1934 was derived, with modifications not here material, from Section 23 (r) (1) of the Revenue Act of 1932: the revenue acts prior to 1932 had not contained any comparable provision limiting deductions for stock losses. No regulations explicatory of Section 23 (r) (1) were promulgated under the Revenue Act of 1932.

However, in a letter of December 29, 1932, to the Commerce Clearing House, Inc. (1933 C. C. H., Federal Tax Rewrite Service, par. 6037) the Commissioner stated that in a joint return the wife's gains from sales of securities might be offset by the husband's losses from such sales, since a "joint single return is treated as if it was the return of a single individual." The view thus expressed by the Commissioner was never embodied in any sort of Treas-

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Regulations 86 and 94, promulgated, respectively, under the Revenue Acts of 1934 and 1936 (Section 51 of those Acts).

The provision in question was somewhat amplified in Article 51-1-(b) of Regulations 101, promulgated under the Revenue Act of 1938 (Section 51). It there reads: "A husband and wife, if living together at the close of the taxable year, may elect to make a joint return (see Section 51 (b)), that is, to include in a single return made by them jointly the income and deductions of each, even though one has no gross income. In such a case, the tax shall be computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income." This expanded version is retained as quoted in Sec. 19.51-1 of Regulations 103, promulgated under the Internal Revenue Code (Section 51).

ury ruling and was not published by the Government.

In G. C. M. 15438, Cum. Bull. XIV–2, p. 156 (1935), on the other hand, the Bureau of Internal Revenue ruled that under the 1932 Act losses sustained by the wife through sales of securities might not be allowed as an offset against gains derived by the husband from like transactions, even though a joint return were filed. This ruling did not refer to the December 29, 1932, letter. Following *Frank B. Gummey,* 26 B. T. A. 894; acquiesence, XIII–2 Cum. Bull. 8, it took the view generally that a husband and wife filing a joint return remain separate taxpayers for the purpose of determining their right to deductions.

Article 117–5 of Treasury Regulations 86, promulgated under the Revenue Act of 1934 and explicatory of Section 117 (d) thereof, squarely and admittedly covers the question here at issue. It reads:

> In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

The provisions of Section 117 (d) of the Revenue Act of 1934 were retained in the same form in Section 117 (d) of the Revenue Act of 1936, and the provisions of Article 117-5 of Regulations 86 were retained in substantially the same form in Article 117-5 of Regulations 94. In both the Revenue Act of 1938 (Section 117) and that of 1939 (Section 212) considerable changes were made in the treatment of capital gains and losses, but in both provisions comparable to those of Section 117 (d) of the Act of 1934 were retained.[9] And Article 117-5 of Regulations 101, promul-

[9] Section 117 (d) (1) of the 1938 Act provided that in the case of a corporation losses from sales or exchanges of capital assets should be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. Section 117 (d) (2) of that Act provided that "In the case of a taxpayer other than a corporation, short-term capital losses shall be allowed only to the extent of short-term capital gains." Section 117 (a) defined short-term capital gains and losses as those resulting from the sale or exchange of a capital asset held for less than 18 months, and defined long-term capital gains and losses as those resulting from the sale or exchange of a capital asset held for more than 18 months.

Section 117 of the 1938 Act was carried over into the Internal Revenue Code, but was thereafter amended by Section 212 of the Revenue Act of 1939 to eliminate the distinction between corporate and other taxpayers. As thus amended the Code provides (Sec. 117 (d)) that "Long-term capital losses shall be allowed, but short-term capital losses shall be allowed only to the extent of short-term capital gains."

gated under the Revenue Act of 1938, and Section 19.117-5 of Regulations 103, promulgated under the Internal Revenue Code, are each to the same effect as Article 117-5 of Regulations 86.[10]

The interpretation of the Act here urged by the Government is thus supported, in the first place, by the provision of Article 51-1 of Regulations 86, and its predecessors, that if a joint return is filed the tax is computed on the aggregate income and all deductions "to which either is entitled shall be taken from such aggregate income." This regulation clearly means that before any deduction may be entered in the joint return it must be a deduction to which either the husband or the wife, separately considered, is entitled under the law. As applied to the case at bar, it means that the husband's own right to deduct a loss on the sale of

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[10] Article 117-5 of Regulations 101 reads:

"Art. 117-5. Application of section 117 in the case of husband and wife.—(a) *Short-term capital gains and losses.*—Under the general rule with respect to taking deductions in a joint return of husband and wife (see article 51-1), a deduction which is not allowable in computing the net income of one spouse making a separate return is not allowable in a joint return made by both spouses. Hence, the limitation under section 117 (d) (2), relating to the allowance of short-term capital losses, is, in the case of one spouse, to be computed without regard to the short-term capital gains and losses of the other spouse, regardless of whether a joint return or separate returns are filed."

Section 19.117-5 of Regulations 103 follows Article 117-5 of Regulations 101 without substantial change.

capital assets must be established before the deduction may be entered in the joint return. Under Section 117 (d) of the 1934 Act the husband may deduct his losses from such sales only to the extent of gains from similar sales, plus $2,000. And under Article 51–1 no further deduction can be calculated and allowed in the joint return on the basis of the wife's gains.

That is the view which was taken of the regulation by the Circuit Court of Appeals for the Second Circuit in the *Pierce* case, decided under the 1932 Act. It said (100 F. (2d) at 398):

> * * * petitioners contend that when husband and wife file a joint return they become a taxable unit with the result that a loss of this character sustained by one spouse is an allowable deduction against gains of the same character received by the other. This contention cannot be sustained in view of the Treasury Regulations and judicial decisions in analogous cases. As already noted, the Regulations provide that the deductions to be taken from the aggregate income of husband and wife shall be those "to which either is entitled." Here neither was entitled to the deduction in question. * * *

As has been stated, Judge Learned Hand dissented in the *Pierce* case, and the reasoning of his dissent was approved in the case at bar (R. 34). Before reaching the conclusion, already discussed,

that the privilege of filing a joint return necessarily involves disregarding the source of deductions, Judge Hand put aside Article 381 of Regulations 77 (the predecessor of Article 51-1 of Regulations 86), as ambiguous. This conclusion he reached by finding uncertainty in the word "entitled". He said (100 F. (2d) at 398):

> The regulations—which I accept as law—add to these words [of Section 51 (b)] that "deductions * * * to which either spouse is entitled shall be taken from the aggregate income". To find the deductions to which "either spouse" is "entitled", one must look to those allowed individuals; in the case at bar to section 23, 26 U. S. C. A. § 23. Subdivision (e) of that section allows losses like those before us to be deducted, "subject to the limitations of subdivision (r)." The Commissioner argues that that clause imposes a condition upon the privilege, as opposed to a limitation upon its amount, so that in order to learn whether a spouse is "entitled" to any deduction whatever, it is first necessary to find out whether the limitation would extinguish it if he or she filed a separate return. The taxpayer answers that § 23 (e) grants the privilege, and therefore "entitles" the spouse to a deduction, and that subdivision (r) merely limits its amount when the joint net income is being computed. As a mere matter of words I can see nothing to prefer in either

> construction; it begs the question to say that the extent of the deduction under a separate return must be taken as a condition upon its existence. * * *

This reading of ambiguity into the regulation is, we submit, unwarranted: the alternative construction accepted by Judge Hand as plausible is hypertechnical and departs from the ordinary meaning of the word "entitled." Mrs. Pierce could not individually deduct her securities losses because under Section 23 (r) they could be offset only against securities gains, and she had none. Thus she was not, under any usual meaning of the term, "entitled" to a deduction for securities losses. It is artificial to suggest, as does Judge Hand, that perhaps she was "entitled" to the deduction and that the deduction was merely limited as to amount—limited, in the *Pierce* case, to zero—by her lack of securities gains. A deduction which cannot be taken is not, in any usual sense, a deduction to which a taxpayer is "entitled."

The court below apparently accepted Judge Hand's treatment of Article 51-1 (or, rather, of its predecessor); in addition it relied upon the Commissioner's letter of December 29, 1932, as showing an administrative construction, up to the promulgation of Article 117-5 of Regulations 86, contrary to the position now taken by the Government. See R. 33-35. This letter was an informal opinion,

never published by the Bureau of Internal Revenue as a ruling, and is not entitled to the weight given to Treasury Regulations (*Helvering* v. *N. Y. Trust Co.,* 292 U. S. 455, 468) or to published rulings of the Internal Revenue Bureau (see *Estate of Sanford* v. *Commissioner,* 308 U. S. 39, 52–53). Moreover, the only published ruling of the Bureau construing Section 23 (r) (1) of the 1932 Act is G. C. M. 15438, XIV–2 Cum. Bull. 156 (1935), and it is directly contrary to the letter. G. C. M. 15438 was not issued until after the Revenue Act of 1934 was enacted, and it is in line with Article 117–5 of Regulations 86, promulgated under the 1934 Act. The Bureau, of course, had power to change its ruling, even if the letter be considered as such. *Helvering* v. *Wilshire Oil Co.,* 308 U. S. 90, 100–101. G. C. M. 15438, is not referred to in the opinion below or in Judge Hand's dissenting opinion in the *Pierce* case, though it would have resolved the ambiguity which Judge Hand found in the regulations.

The Treasury Department has, we think, taken the general position ever since 1921, through the predecessors of Article 51–1 of Regulations 86, that even though a joint return is filed only those deductions can be taken which would be allowable to one or the other of the spouses singly. And after the enactment of Section 23 (r) (1) of the 1932 Act gave rise to the specific question here in issue, the only official ruling under that Act unequivocally

interpreted the Act as here urged by the Government.

But whatever the administrative construction of the 1932 Act, the regulations under the 1934 Act admittedly cover the present case, and, we submit, should be controlling. Article 117–5 of Regulations 86, set out *supra,* p. 37, explicitly provides that the limitation "on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets."

This regulation directly covers the question at bar. The court below gave two reasons for its refusal to give effect to it, namely: (1) that it was invalid because inconsistent, not with the provisions of Section 117 (d), but with the provisions of Section 51 (b); and (2) that the administrative construction had not been consistent and had not in reality received legislative approval. The former contention has been dealt with; the latter, is, we think, untenable.

The asserted lack of consistency in the administrative construction refers to the Commissioner's letter of December 29, 1932. As stated, we do not think that that letter is entitled to any weight, and it was, moreover, tactily repudiated by G. C. M. 15438. In any event some ambiguity in the administrative construction prior to the promulgation of Article 117–5 of Regulations 86 would not vitiate

the effect of subsequent congressional approval of that Article.

The conclusion of the court below that Article 117-5 did not receive legislative sanction is based on the fact that in Section 51 (b) of the Revenue Act of 1938 Congress made certain changes from the 1936 Act in the provisions regarding the filing of joint returns. But Article 117-5 had already received tacit legislative approval when Congress enacted both Section 51 (b) and Section 117 of the Revenue Act of 1936, without change from the 1934 Act. See *Hassett* v. *Welch*, 303 U. S. 303, 312. Moreover, the 1938 modification of Section 51 (b) was directed to a wholly different problem. No change was made in the provision that if a joint return was filed the tax should be computed on the aggregate income, but for the first time the statute provided that liability for the tax should be joint and several. Previous statutes had not contained any provision as to liability for the tax, and two courts had held that in the absence of a provision making the liability both joint and several, one spouse could not be held liable for a deficiency attributable to the other spouse's income. See *Cole* v. *Commissioner*, 81 F. (2d) 485 (C. C. A. 9th), and *Crowe* v. *Commissioner*, 86 F. (2d) 796 (C. C. A. 7th). Accord: *Commissioner* v. *Rabenold*, 108 F. (2d) 639 (C. C. A. 2d), and compare *Rogers* v. *Commissioner*, 111 F. (2d) 987 (C. C. A. 6th). It was solely to remedy this

loophole with respect to the collection of the tax that Section 51 (b) was modified. See H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 29–30; *Commissioner* v. *Rabenold*, 108 F. (2d) 639, 640–641 (C. C. A. 2d); (1940) 49 Yale L. J. 1279, 1284. The enactment of this provision dealing with collection did not in any way indicate Congressional disapproval of Article 117–5 of Regulations 86, which had already received tacit Congressional approval. If Congress had disapproved the interpretation given Section 117 (d) of the 1934 Act by Article 117–5, it would undoubtedly have incorporated in some subsequent act a provision expressly dealing with the treatment of capital losses in joint returns. But it did not do so. While Section 117 of the Revenue Act of 1938 made substantive changes in the treatment of different classes of capital losses, it nevertheless provided that short term capital losses should be deducted only to the extent of short term capital gains, without indicating how the limitation was to be applied in the case of joint returns.

Consequently, the interpretation given the statutory provision by Article 117–5 of Regulations 86, which received legislative approval through the enactment of identical statutory provisions in the Revenue Act of 1936 and of analogous provisions in the Revenue Acts of 1938 and 1939, now has the force and effect of law. *Helvering* v. *Win-*

mill, 305 U. S. 79; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488; *Hassett* v. *Welch,* 303 U. S. 303; *Helvering* v. *Wilshire Oil Co.,* 308 U. S. 90.[11]

CONCLUSION

For the reasons stated it is respectfully submitted that the decision of the court below should be reversed.

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SEPTEMBER, 1940.

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[11] (1940) 53 Harv. L. Rev. 681, 682, discussing the decision below in the present case, states:

"Thus whatever the merits of the unit theory as a matter of *de novo* interpretation of the policy of a vague statute, it would seem that this was not the construction generally given to it by the courts, or by the Treasury Regulation promulgated under statutory provisions which were subsequently reenacted by Congress."

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

[U. S. C., Title 26, Sec. 51.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or

face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

[U. S. C., Title 26, Sec. 101.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 51–1. *Individual returns.*—For each taxable year every single person and every married person not living with husband or wife for any part of the taxable year, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is $1,000 or over, must make a return of income. Every married person living with husband or wife for any part of the taxable year, but not at the close of the taxable year, must make a return if his gross income for the taxable year is $5,000 or more, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family). (See article 25–7.) A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together at the close of the taxable year but not during the entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or

more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as the head of a family). (See article 25–7.) If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year.

* * * * *

ART. 117–5. *Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assests.

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In the

Supreme Court of the United States

October Term, 1940

No. 36

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

WALTER C. JANNEY AND PAULINE F. M. JANNEY,

Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit

BRIEF FOR THE RESPONDENTS

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BRIEF FOR THE RESPONDENTS.

Statements of Opinion Below, Jurisdiction, Question Presented, Statute and Regulations Involved, and the Facts.

The statements on these points on pages 1 to 4 and pages 34 to 37 of the Petitioner's brief are accepted by the Respondents.

Summary Statement of Respondents' Argument.

1. Section 117(d) of the Revenue Act of 1934 was not intended to change the long-established rule that, in a joint return of husband and wife, the net capital loss of one

spouse is to be offset against the net capital gain of the other in computing the amount of their joint taxable gain, if any.

2. The arguments of the Petitioner in support of the opposite view are unsound.

Respondents' Argument.

1. Section 117(d) of the Revenue Act of 1934 was not intended to change the long-established rule that, in a joint return of husband and wife, the net capital loss of one spouse is to be offset against the net capital gain of the other in computing the amount of their joint taxable gain, if any.

Section 51(b) of the Revenue Act of 1934 (and the cognate sections of earlier acts as far back as the Revenue Act of 1918) provides that:

> "If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—
>
> (1) Each shall make such a return, or
>
> (2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income."

There is nothing in Section 51 which, in express terms, provides for the deduction of the expenses or losses of either spouse if they elect to file a joint return.[1] But for the cogent reasons set forth as early as 1921 in *Solicitor's Opinion 90*, 4 Cum. Bull. page 236,[2] the Treasury Depart-

[1] The entire Section is given in the Appendix to this brief.

[2] The full text of this Opinion is given in the Appendix to this brief.

ment has consistently held that "the aggregate income" means the aggregate *net* income and that, in filing a joint return, one spouse is entitled to offset his expenses, interest, taxes and losses against the income of the other. And from the time that capital gains and losses were accorded special treatment for purposes of the income tax (the Revenue Act of 1921), the Bureau of Internal Revenue permitted one spouse to offset his or her capital losses against the capital gains of the other, in computing the amount of net capital gain to be reported in a joint return. If there was any excess of capital losses over capital gains, the excess was in effect allowed as a partial offset against the joint income from other sources.

But in administering the Revenue Act of 1934 the Commissioner of Internal Revenue ruled (and here seeks to have this ruling sustained) that in computing the net capital gain to be included in a joint return, the capital gain of one spouse is to be reduced, not by the entire capital loss of the other, but by a maximum of $2,000. He maintains that this ruling is required or supported by subsection (d) of Section 117—the "Capital Gains and Losses" section—of the Revenue Act of 1934, reading as follows:

> "(d) Limitation on Capital Losses—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

The Respondents submit that this provision has no relevant bearing whatsoever on the question of whether or not Congress intended to continue to permit the entire amount of the capital losses of one spouse to be offset against the capital gains of the other in determining the amount of net capital gain, if any, to be reported for tax. They maintain that Section 117(d) comes into play, by its very terms,

only when the question of how much deductible net capital *loss* is to be allowed; the question that would be raised if Mr. and Mrs. Janney, instead of having a joint net *gain* of $2,527.65, had had a joint net *loss* of that amount. Then, and then alone, under the Respondents' view, Section 51(d) would come into play and limit the deductible loss—the loss deductible from ordinary income—to $2,000.

This view is squarely sustained by the reports of the Committee on Ways and Means of the House and the Committee on Finance of the Senate on the Revenue Bill of 1934, giving the reason for the proposed restriction on the deduction for capital losses previously allowed. The House Committee said:

> "Your committee has examined the British system, which disregards these" (capital) "gains and losses for income-tax purposes. The stability of the British revenue over the last 11 years is in marked contrast to the instability of our own. In that period the maximum British revenue was only 35 per cent above the minimum, while in our own case the percentage of variation was 280 per cent.
>
> * * * * *
>
> "* * * The method proposed is safe from a revenue standpoint, inasmuch as capital losses can not be used to reduce ordinary income, while gains are taxed in full or in part in proportion to the time for which the property has been held * * *" (H. Rept. No. 704 (73d Cong., 2d Sess.), p. 10 (Feb. 12, 1934)).

It will be observed that the Committee said nothing whatever about forbidding a husband and wife, who file a joint return, from offsetting the capital gains of the one by the capital losses of the other. Moreover, the plain inference of what the Committee did say is that it intended no such limitation, because allowing one spouse to offset capital losses solely against the capital gains of the other

does *not* permit the spouses to use capital losses to "reduce ordinary income"—the feature of the existing system which it was proposed to eliminate.

The Senate had the same intention as the House, as appears from the following statement in the Senate Committee report:

> "Your committee concurs in the general features of the plan proposed by the House Bill, but believes a few modifications should be made therein.
>
> * * * * *
>
> "Third, in the case of the general limitation provided in the House bill that capital losses should only be allowed to the extent of the capital gains, your committee recommends that $2,000 of such excess of losses may be charged off from ordinary income * * *" (Sen. Rept. No. 558 (73d Cong., 2d Sess.), p. 12 (Mar. 28, 1934)).

The Respondents submit that Section 117(d), embodying the House proposal as slightly amended to conform to the Senate recommendation, gives no support whatsoever to the Petitioner's position that Congress intended in the 1934 Act to change the previously well-established rule that a husband and wife, filing a joint return, could reduce the capital gains of one by the capital losses of the other, in determining the amount of net capital gain, if any, subject to tax.

2. The arguments of the Petitioner in support of the opposite view are unsound.

(a) The Van Vleck and Related Cases.

The Petitioner's principal argument is not that the decision below is intrinsically unsound, but that it is in conflict with other decisions and the Treasury Regulations.

The first group of allegedly conflicting decisions is that beginning with *Van Vleck* v. *Commissioner*, 80 F. (2d) 217 (C. C. A. 2d, 1935), cert. den. 298 U. S. 656.

The facts in the *Van Vleck* case were as follows: In 1930 Mrs. Van Vleck had a large income. Her husband had sustained business losses far in excess of all his income from other sources in 1929 and again in 1930. Mr. and Mrs. Van Vleck filed a joint return in 1930, in which the wife claimed as a deduction from her income, not only her husband's losses for 1930, but also his losses for 1929. She based her claim to this latter deduction on Section 117(b) of the Revenue Act of 1928, which provided that:

> "If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year * * *."

Under the long-established rulings and practice of the Treasury Department, the Commissioner of Internal Revenue held that the deduction of the husband's 1930 losses was correct, but he ruled that the deduction of the husband's *1929* losses was not permissible. His ruling was based on the following language of Section 117(b):

> "If, * * * any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year * * *."

coupled with the following language of Section 117(a)(6):

> "In computing a net loss for any taxable year a net loss for a prior year shall not be allowed as a deduction."

The Commissioner argued that a husband and wife, even though they filed joint returns, remained separate taxpayers; that Section 117(b) permitted the carryover loss deduction (an extraordinary allowance at best) only to "the taxpayer" who had sustained the loss; that in the instant case "the taxpayer"—the husband—already had a net loss for 1930, without counting in his 1929 loss; and that Section 117(a)(6) explicitly declared that:

> "In computing the net loss for any taxable year a net loss for a prior year shall not be allowed as a deduction."

The Circuit Court of Appeals for the Second Circuit sustained the Commissioner's position, saying (p. 218):

> "* * * the right to carry over is expressly limited to 'any taxpayer [who] has sustained a net loss,' and the right to use the deduction is as expressly limited to 'computing the net income of the taxpayer' for the succeeding year or years. It follows that the only taxpayer who could use the husband's 1929 net loss in computing net income for 1930 was the taxpayer who sustain^d the loss, i. e., the husband himself. But it so happens that his right to take it into the computation is so restricted" (by Section 117(a)(6)) "that he could not even do this * * *."

In the *Pierce, Demuth, Sweet* and *Nelson* cases, relied on by the Petitioner (pp. 10 to 12 of Petitioner's brief), the Courts sustained the Commissioner's position that in a joint return spouses could not offset the non-capital stock losses of one against the non-capital stock gains of the other, because of the provision in Section 23(r)(1) of the Revenue Act of 1932, that:

> "Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section)

which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by the taxpayer from the retirement of his own obligations)."

The first case to arise under this Section—the *Pierce* case—came before the Second Circuit which had decided the *Van Vleck* case. The Commissioner argued and the Court held that the decision in that case was decisive of the *Pierce case.* Judge LEARNED HAND wrote a strong dissent. The later cases, involving this same Section—Section 23(r)(1)—followed, without much reasoning, the majority decision in the *Pierce* case.[3]

The case of *Taft* v. *Helvering,* 111 F. (2d) 145 (C. C. A. 2d, 1940), arising under the 1934 Act, holds that the charitable contributions of one spouse cannot be deducted from the income of the other, even though the aggregate contributions of the two are less than 15 per cent of the net income reported in the joint return. This decision was

[3] The per curiam opinion in *Nelson* v. *Commissioner,* 104 F. (2d) 521 (C. C. A. 4th, 1939) states:

> "While a majority of this Court are much impressed with the reasoning of Judge LEARNED HAND in his dissenting opinion in the *Pierce* case, the legal question involved is a close one, and we feel that we should follow the decisions of the First and Second Circuits, particularly in view of the denials of certiorari by the Supreme Court. We are told that no inference should be drawn from the denial of certiorari, but it is hard to imagine that certiorari would have been denied in a case of this character unless the Court was satisfied of the correctness of the decision below, particularly if its correctness had been challenged by a dissenting opinion."

The inference of this language is that the Court of Appeals in the *Nelson* case was swayed by the denial of certiorari in the *Pierce* and *Sweet* cases. If so, the Court must have overlooked the following statement of Mr. Justice HOLMES in *U. S.* v. *Carver,* 260 U. S. 482, 490 and *Atlantic Coast Line R. R. Co.* v. *Powe,* 283 U. S. 401, 403-4:

> "The denial of a writ of certiorari imports no expression of opinion upon the merits of the case, as the bar has been told many times."

based on the following provision of Section 23 of the Revenue Act of 1934:

> "In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (o) Charitable and Other Contributions. In the case of an individual, contributions or gifts made within the taxable year to or for the use of" (naming various public or charitable uses) "to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection * * *."

In this case the Court simply followed the earlier decisions in the same (Second Circuit) Court, without setting forth any reasoning in support of its decision.

The decision in the *Van Vleck* case was probably sound. The permission to carry over losses from one year to the next was a most exceptional one, and there was reason for the Courts to believe that Congress intended that the allowance be narrowly circumscribed by emphasizing the significance of the term "taxpayer". But there is no reason to believe that Congress intended that a similar emphasis be given to the word as used in Section 23(r)(1) of the 1932 Act or Section 23(o) of the 1934 Act. The latter is particularly questionable, because the members of Congress must have been aware that it is common practice for the wife to make out of her allowance most of the charitable contributions for both members of the family, and it is difficult to believe therefore that Congress intended that, in a joint return, the deduction for charitable contributions should be limited to 15 per cent of the income—frequently little or nothing—of the wife alone. To give the word "taxpayer" the same significance through-

out the Revenue Acts as in the loss carry-over provision leads to almost absurd results.

But even if "taxpayer" must be given the same restrictive significance whenever and wherever it appears in one of the Revenue Acts, such a view would not sustain the Government's position in the present case, because Congress did not use the word "taxpayer" in Section 117(d) of the Revenue Act of 1934. The Commissioner has in effect read into this Section the following words in brackets:

> "Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains" [of the taxpayer] "from such sales or exchanges."

But Congress itself did not employ the words "of the taxpayer", and there is no reason to believe that Congress intended that a husband and wife, filing a joint return, should be subjected to the limitation which might possibly be implied if these words had been used.

(b) The Thomas and Related Cases.

Petitioner also relies (p. 19 of his brief) on the decision, and the alleged logical consequence of the decision, in *Commissioner* v. *Thomas,* 84 F. (2d) 562 (C. C. A. 5th, 1936), the facts of which are as follows: In 1930, Thomas sold some stock to his wife at a loss. His wife and he filed a joint return, in which this loss was claimed as a deduction. The Commissioner disallowed this loss. But the Court held that the filing of the joint return did not destroy the separate identities of the two spouses and that the loss should be allowed, saying (p. 563):

> "* * * Section 51 *supra,*" (the joint returns section of the 1928 Act) "is clearly intended by Congress

to be in favor of the taxpayer. Therefore, it should be liberally construed to effectuate that intention * * *."

Several other similar cases, cited in Petitioner's brief (p. 19), have been similarly decided. The Petitioner maintains that the necessary consequence of these decisions is that Congress must be held to have intended that, under the 1934 Act, the capital losses of one spouse cannot be offset against the capital gains of the other.

Respondents believe that the decisions in the *Thomas* and related cases reach a result which Congress did not intend and are of doubtful validity in the light of the recent decision of this Court in *Higgins* v. *Smith*, 308 U. S. 473, holding that the sale at a loss of property by a stockholder to a corporation which he controls results in no deductible loss. But even if the decisions in the *Thomas* and related cases must stand, it does not follow that the decision of the Court below in this case should fall. This Court recently held in the case of *United States* v. *Pleasants*, 305 U. S. 357, that theoretical consistency need not be adhered to at all costs in the construction of taxing Acts. In that case this Court held that, even though net capital *gains* are included in computing the income base to which the 15 per cent limitation on charitable contributions applies, taxpayers are not required to include net capital *losses* in computing this basic figure. This Court said (pp. 362-3):

"There is nothing to the contrary in our decision in *Helvering* v. *Bliss*, *supra*. In that case there was a capital net gain. The net income of the taxpayer comprehended that net gain as well as his net income otherwise computed. We decided that it was his total net income which was to be regarded as the basis for the allowance under § 23(n). We found nothing in

§ 101, which in that application prescribed 'mer
a method for segregating a portion of that
income for taxation at a special rate,' that in a
wise altered the right of the taxpayer to take
deduction in accordance with § 23(n). *Id.,* 150, 1
Here, instead of a capital net gain, we have a cap
net loss. There is no gain to be added to the t
payer's net income otherwise computed and thus t
is the only net income taxable under the statute.
that net income, the provision of § 23(n) appropria
applies. We observed in the *Bliss* case that the
emption of income devoted to charity and the red
tion of the rate of tax on capital gains 'were liberali
tions of the law in the taxpayer's favor, were begot
from motives of public policy, and are not to be n
rowly construed.' That observation is equally pe
nent here."

(c) The Cole and Related Cases.

Petitioner also relies (p. 20) on the decisions in *C*
v. *Commissioner,* 81 F. (2d) 485 (C. C. A. 9th, 1935) (Ju
Denman dissenting), and similar cases. In these cases
Court held that the liability of spouses filing a joint
turn was not joint but several, and that the liability
each must be determined by the Commissioner by wo
ing out, through an analysis of the items of income
deductions of each spouse (sometimes a most complex pr
lem), the proportionate *net* income contributed by each
the joint return.

Respondents submit that these decisions are unsou
They believe that the sound view was stated by Ju
Patterson of the Second Circuit Court of Appeals in
dissenting opinion in *Commissioner* v. *Rabenold,* 108
(2d) 639 (C. C. A. 2d, 1940), not cited by the Petitio
on this point. In that case, involving precisely the sa
question as that in the *Cole* case, Judge Patterson s
(p. 641):

"I dissent. The respondents, husband and wife, saw fit to file a single joint income tax return for 1933. The Revenue Act of 1932, like prior acts, gave them the right to file 'a single joint return' and declared that in such case 'the tax shall be computed on the aggregate income.' The obvious result, it seems to me, is that husband and wife who file a single return are to be treated as a single taxpayer and are jointly liable for the tax * * *."

The *Rabenold* case is also interesting as showing that as late as January, 1940, the Petitioner, in a case somewhat similar to the present, was arguing squarely contrary to the position which he seeks to maintain in the present case.

(d) **The Treasury Regulations Issued in 1935 Are Not Decisive, at Least as to Years Prior to 1936.**

Petitioner maintains that Article 117-5 of Treasury Regulations 86, issued under the 1934 Act, is in accord with his position in the present case, and that this Article is decisive because it has "received tacit Congressional approval through the enactment of identical statutory provisions in the Revenue Act of 1936 and of analogous provisions in the Revenue Acts of 1938 and 1939." (Petitioner's brief, p. 7.)

A somewhat similar line of argument was advanced by the Petitioner and rejected by this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110 (1939), involving the question whether or not a corporation was subject to tax on profits derived from the purchase and sale of its own stock in 1929. At the time the sales were made, and long prior thereto, the Regulations provided that dealings by a corporation in its own stock were to be disregarded for income tax purposes. In 1934, the Treasury

Department reversed its position and ruled that such dealings give rise to profit or loss for income tax purposes. The 1936 and 1938 Acts, passed after this new ruling, made no change in the language of the 1934 and earlier Acts bearing on the question. The Commissioner argued, in the *Reynolds* case, that this showed that Congress had adopted the new administrative construction, not only with respect to the years covered by the 1936 and 1938 Acts, but with respect to earlier years as well. This Court rejected the Commissioner's contention, saying (p. 117):

> "It may be that by the passage of the Revenue Act of 1936 the Treasury was authorized thereafter to apply the regulation in its amended form. But we have no occasion to decide this question since we are of opinion that the reënactment of the section, without more, does not amount to sanction of retroactive enforcement of the amendment, in the teeth of the former regulation which received Congressional approval, by the passage of successive Revenue Acts including that of 1928."

In the present case, the Commissioner first gave notice of his position that the capital losses of a wife could not be offset against the capital gains of a husband, in computing the amount of net capital gain to be reported in a joint return, in Article 117-5 of Treasury Regulations 86, published March 2, 1935.[4] The reasoning of this Court in the *Reynolds* case indicates that the Revenue Acts of 1936 and 1938 should perhaps be construed in conformity with Article 117-5 of Regulations 94, but that the Revenue Act

[4] 1935 C. C. H. Federal Tax Service, Vol. 3, par. 5188. The Regulations were dated September 6, 1934, but were not *published* (*i. e.,* made public) until the date stated. The cover of the printed Regulations contains the imprint "United States Government Printing Office, Washington: 1935."

of 1934—the Act which covers the year here involved—should not be.

Petitioner also seeks to support his position by asserting (p. 7 of his brief) that:

> "* * * Ever since 1921 the Treasury has taken the general position that even in a joint return only those deductions can be taken 'to which either spouse is entitled.' Article 401 of Regulations 62 * * *."

But this statement gives a misleading twist to the Regulations by implying, through the use of the word "only", that the sentence quoted from the Regulations was by way of limitation. As clearly appears from the following fuller quotation from Article 401, this was not the fact:

> "* * * If an individual is a married person living with husband or wife, no return need be made unless their aggregate gross income is at least $5,000 or their aggregate net income is at least $2,000; but a separate return must be made by each of them, regardless of the amount of the individual income of each, where their aggregate gross income is $5,000 or over, or their aggregate net income is $2,000 or over, unless they join in a single joint return. Where the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income * * *."

(e) **The Unfairness of Petitioner's Position.**

If the language of Congress plainly supported the Petitioner's contention, the question of fairness would presumably have to be ignored by this Court. But, as brought out under the first heading of this brief, the language of Section 117(d) of the 1934 Act does not do this. The question of fairness is therefore pertinent.

If Congress had intended in the 1934 Act to establish an exception to the general rule permitting spouses to pool income and deductions, it is reasonable to assume that there would have been some discussion of the proposed change in the Committee reports on the new Revenue Bill and that the draftsmen of the new Act would in fairness have used clear-cut language to bring home to the millions of married taxpayers who had grown accustomed to the existing practice, such proposed singular exception to the pre-existing general rule. Yet, as has been shown, there is nothing in the Committee reports which indicates any such intention (the implication, indeed, is, as has been pointed out, squarely to the contrary) and nothing in the Act which expresses such an intention.

Furthermore, the question whether an exception was intended under a similar section, Section 23(r)(1), of the Revenue Act of 1932 (discussed under an earlier heading of this brief) had been submitted to the Commissioner of Internal Revenue and answered by him as follows on December 29, 1932:

> "Reference is made to your letter dated December 6, 1932, relative to the treatment of gains and losses from the sale of securities by a husband and wife for the year 1932 where a joint income tax return is filed by them. In the illustration or example presented the wife has a gain and the husband has a loss from the sale of securities, each being in the amount of $10,000.00. The specific question presented is whether the loss sustained by the husband may be applied to offset the same amount of gain realized by the wife in rendering joint income tax return for the year.
>
> "* * * If it is correctly understood from your letter that the gains and losses in the illustration presented are from transactions falling within the same class within the meaning of the statute such as sales of

securities not held for a period of more than two years the loss sustained by the husband would offset the same amount of gain realized by the wife from such source."

Signed by David Burnet, Commissioner (symbols IT:E:RR:GNW) (reported in 1933 Commerce Clearing House Federal Tax Service, Vol. III, par. 6037).

This ruling of the Commissioner of Internal Revenue showed by its symbols "RR" (standing for the Rules and Regulations Section of the Bureau, which draws up the Treasury Regulations) that it was of an authoritative character. It was published in the Commerce Clearing House Tax Service for 1933, and, being favorable to the taxpayer, was generally regarded as final. The ruling was re-published in the 1934 Commerce Clearing House Federal Tax Service (Vol. I, par. 340J. 10) and was given wide circulation in *Robert H. Montgomery's Federal Tax Handbook for 1934-5,* which, after quoting Commissioner Burnet's letter of December 29, 1932, says (p. 465):

"The above letter was written in connection with section 23(r) of the 1932 law. However, the reasoning employed is likewise applicable to the provisions of Section 117 of the 1934 law and leads to the conclusion that if husband and wife make a joint return, losses of one on the sale of capital assets can be offset against similar gains of the other in the joint return."

The ruling was still in force on May 10, 1934, when the Revenue Act of 1934 was enacted. It remained unchallenged until the publication of Treasury Regulations 86 on March 2, 1935, when, for the first time, notice was in effect given by the Commissioner that this earlier ruling would not be followed.

Thus throughout the years 1933 and 1934 taxpayers were led by the Commissioner's ruling to believe that the securities losses of one spouse could be offset against the securities gains of the other, and naturally acted in reliance on this belief. To hold now that they were not entitled to rely on the ruling would be patently, and (since the Act does not so require) gratuitously, unfair.

Conclusion.

The decision of the Court below is correct and should be affirmed.

Respectfully submitted,

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Of Counsel:
HARRY J. RUDICK.

October, 1940.

APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680:

Section 51. (a) Requirement.—The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $2,500 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

(b) Husband and Wife.—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

(c) Persons Under Disability.—If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

(d) Fiduciaries.—For returns to be made by fiduciaries, see section 142.

[U. S. C. Title 26, Sec. 51.]

Solicitor's Opinion 90, 4 Cum. Bull. 236 (1921):

Income Tax—Revenue Act of 1918, Sections 210, 211, 216(c) and 223.

Husband and wife living together may, at their option, file separate returns of income or a single joint return.

If husband and wife living together file a single joint return of income, such return is treated as the return of a taxable unit and the income disclosed by the return is subject to both normal and surtax as though the return were that of a single individual.

If a husband or wife has allowable deductions for any taxable year in excess of his or her gross income for such year, such excess may, if the husband and wife are living together and a single joint return of income is filed, be deducted from the net income of the other spouse for the purpose of computing both the normal and surtax.

The question has arisen whether a husband and wife living together may file a joint return of income under the Revenue Act of 1918, and, if so, in what manner the tax due upon such joint return should be computed. The specific question presented is whether in cases in which a husband and wife living together render a joint return for a year during which the husband or wife has allowable deductions under section 214 of the Act in excess of his or her gross income from all sources, such excess may properly be deducted from the net income of the other for the purpose of computing either the normal or surtax imposed by sections 210 and 211 of the statute.

Sections 210 and 211 of the Revenue Act of 1918 provide that the normal and surtax shall be levied, collected, and paid upon the net income of "every individual." Sections 216 and 223 of the Act read, in part, as follows:

Sec. 216. That for the purpose of the normal tax only there shall be allowed the following credits: * * *

(c) In the case of a single person, a personal exemption of $1,000, or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,000. A husband and wife living together shall receive but one personal exemption of $2,000 against their aggregate net income; and in case they make separate returns, the personal exemption of $2,000 may be taken by either or divided between them.

Sec. 223. That every individual having a net income for the taxable year of $1,000 or over if single, or if married and not living with husband or wife, or of $2,000 or over if married and living with husband or wife, shall make under oath a return stating specifically the items of his gross income and the deductions and credits allowed by this title. If a husband and wife living together have an aggregate net income of $2,000 or over, each shall make such a return unless the income of each is included in a single joint return.

It has been suggested that, in view of the specific provision of sections 210 and 211 that the normal and surtax shall be levied upon the net income of every individual, section 223 does not permit a husband and wife living together to file a joint return as a taxable unit, but merely permits the filing of a joint return of separate incomes, or two ordinary returns on one sheet of paper, for convenient reference.

But one provision of a statute, however specific, must not be so construed as to nullify the plain import of another provision, when by any reasonable construction effect can be given to both provisions. When a general statutory provision is followed by a provision that certain specific cases shall be treated in a different manner, an exception must be made to the former to give full effect to the latter.

It is true that there is no provision in the Act which affirmatively permits the filing of joint returns by husband and wife living together, and authority for such returns must be found by inference from sections 216(c) and 223. However, the inference, if clear, must be given effect.

The popular and received import of words furnishes the general rule for the interpretation of public laws. *Maillard* v. *Lawrence*, 16 How. 251, 14 L. Ed. 925.

It is unnecessary to refer to the definitions given by the dictionaries for the word "joint" to reach the conclusion that the "popular and received import" of the language of section 223 is that the single joint return referred to is one return of a taxable unit and not two returns of two taxable units on one sheet of paper.

There is other language in the statute, however, which more clearly requires such construction. Section 216(c) provides that but one personal exemption of $2,000 shall be taken by husband and wife living together "against their aggregate net income." If the single joint return referred to in section 223 is merely two separate returns on one sheet of paper, there is no "aggregate net income" against which the deduction can be taken. And the statute does not provide by whom the exemption shall be taken in such cases, or whether it may be divided. The last clause of section 216(c) which provides that the personal exemption may be taken by either or divided, applies only when separate returns are filed.

If the single joint return which husband and wife living together are permitted to file by section 223 is merely a joint return of separate incomes, or two returns on one sheet of paper, the only explanation that can be offered for the action of Congress in permitting the filing of such returns is that such joint returns permit more convenient reference in the Bureau

of Internal Revenue, a matter of expediency in administering the taxing statute. It is no more expedient from an administrative standpoint, however, to have the separate returns of husband and wife living together attached to each other, than to have the separate returns of other individuals so attached, as, for instance, the returns of partners or of husband and wife not living together.

Had the provision been intended by Congress as one of administrative expediency, the filing of joint returns would not have been made optional with the taxpayer. If Congress did not intend that husband and wife in such case might file returns as a taxable unit, it considered either that the law would or would not be more easily administered if joint returns were filed by husband and wife living together, and accordingly joint or separate returns would have been required. Certainly no option would have been given to the taxpayer in a matter of governmental administrative expediency.

It is by no means unreasonable to suppose that it was the intention of Congress that husband and wife living together should, if to their advantage, be permitted to file a joint return as a taxable unit. Congress may well have considered it advisable that a net loss sustained by one spouse should be deducted in computing the tax of the other. It is true that husband and wife are not treated throughout the Act as a taxable unit, but Congress may have considered such provision inexpedient or of doubtful constitutionality.

From the foregoing it follows that the proper construction of the Revenue Act of 1918 permits a husband and wife living together, at their option, to file separate returns or a single joint return. If a single joint return is filed it is treated as the return of a taxable unit and the net income disclosed by the return is subject to both normal and surtax as though the return were that of a single individual. In cases,

therefore, in which the husband or wife has allowable deductions in excess of his or her gross income, such excess may, if joint return is filed, be deducted from the net income of the other for the purpose of computing both the normal and surtax.

Carl A. Mapes
Solicitor of Internal Revenue

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 113

CHESTER GAINES and THERESA GAINES,
Husband and Wife,

Petitioners,

v.

GUY T. HELVERING, Commissioner of Internal
Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

FRANK E. KARELSEN, JR.,
Counsel for Petitioners.

FREDERICK BAUM,
of Counsel.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE, AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitioners, Chester Gaines and Theresa Gaines, pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above cause on May 8, 1940, affirming the decision of the Board of Tax Appeals.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 15) is unreported. The *per curiam* opinion of the Circuit Court of Appeals (R. 27) is not yet officially reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 8, 1940 (R. 27). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Whether, under Section 117 (d) of the Revenue Act of 1934, a husband and wife filing a joint return may deduct losses sustained by the wife from the sale of capital assets to the extent of gains realized by the husband from similar sales.

Statute and Regulations Involved.

The pertinent statute and regulations will be found in the Appendix, *infra*, pp. 7-10.

Statement.

The facts as stipulated (R. 23) and adopted by the Board of Tax Appeals are substantially as follows:

The petitioners were married and living together in New York City, New York, throughout the year 1934 (R. 23).

During that year, the husband, Chester Gaines, realized a net gain from the sale of capital assets of $18,466.41, the entire amount of which was to be taken into account under Section 117 (a) of the Revenue Act of 1934 (R. 23). During the same year, the wife, Theresa Gaines, sustained a net loss from the sale of capital assets in the amount of $35,959.86, of which the amount to be taken into account under Section 117 (a) of the Revenue Act of 1934 was $20,031.59 (R. 23).

The petitioners filed a joint income tax return for 1934 (R. 24). In the return, the net capital gain of the husband

in the amount of $18,466.41 was included in gross income, and the net capital loss of the wife in the amount of $20,031.59 was deducted (R. 24).

In auditing the return, the Commissioner refused to permit the net loss sustained by the wife to be offset against the net gain realized by the husband, and disallowed the deduction of the $20,031.59 net capital loss of the wife, except to the extent of $2,000 thereof (R. 24). On the basis of such disallowance, the Commissioner determined a deficiency of $5,008.55 (R. 13). The Board of Tax Appeals sustained the Commissioner's determination (R. 16). The Circuit Court of Appeals affirmed the Board (R. 27).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that under Sections 117 (d) and 51 (b) (2) of the Revenue Act of 1934, a loss sustained by one spouse from the sale of capital assets is not deductible to the extent of the gain realized by the other spouse from similar sales where a joint return is filed.

2. In holding that under Sections 117 (d) and 51 (b) (2) of the Revenue Act of 1934, the excess of the losses of one spouse over his or her gains from the sale of capital assets is not deductible from the gains of the other spouse from similar sales when a joint return is filed.

3. In holding that, when a joint return is filed, the limitation under Section 117 (d) of the Revenue Act of 1934 upon the allowance of losses from the sale of capital assets is to be computed separately as to each spouse with respect to his or her individual transactions, and without regard to the gains or losses of the other spouse from similar sales.

4. In not holding that, when a joint return is filed, Section 117 (d) of the Revenue Act of 1934 limits the de-

ductibility of losses sustained by each spouse from the sale of capital assets only to the extent of the aggregate gains realized by both spouses (plus $2,000) from similar sales.

Reasons for Granting the Writ.

1. The decision of the Court below is in square conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Janney* v. *Commissioner,* 108 F. (2d) 564. This Court granted a writ of certiorari in the *Janney* case on April 29, 1940, upon the petition of the Commissioner (*Helvering* v. *Janney,* No. 843, October Term, 1939, certiorari granted April 29, 1940).

The question in the instant case is the same as the question in the *Janney* case, both arising under the Revenue Act of 1934. In the instant case, the *per curiam* opinion of the Court below affirmed the decision of the Board "upon the authority of *Pierce* v. *Helvering,* 100 F. (2d) 397 (C. C. A. 2)" (R. 27). In the *Janney* case, the Court expressly rejected the decision in the *Pierce* case (108 F. [2d] at 566).

2. This case presents an important question of federal law which has not been, but should be, definitely settled by this Court.

The question is raised by the provision which has been included in the income tax law ever since the Revenue Act of 1932, limiting the deductibility of losses to the extent of gains from the sale or exchange of assets. The interpretation of this limitation in the 1932 Revenue Act with reference to a joint return first came before the appellate Courts in *Pierce* v. *Commissioner* (*supra*). In that case, the Court of Appeals for the Second Circuit held that, under Section 23 (r) of the Revenue Act of 1932, the losses of one spouse from sales of securities constituting non-capital assets could not be offset against the gains of the other spouse from similar sales in a joint return. Judge

Learned Hand filed a strong dissenting opinion (100 F. [2d] at 398).

The *Pierce* case has been followed by the Courts of Appeals for the First and Fourth Circuits solely in deference to its prior precedent and not because of independent reasoning impelling the same conclusion. Thus in *Nelson* v. *Commissioner,* 104 F. (2d) 521, the Court of Appeals for the Fourth Circuit indicated that a majority agreed with Judge Hand's dissent:

> "While a majority of this Court are much impressed with the reasoning of Judge Learned Hand in his dissenting opinion in the *Pierce* case, the legal question involved is a close one and we feel that we should follow the decisions of the First and Second Circuits, particularly in view of the denials of certiorari by the Supreme Court."

In *Sweet* v. *Commissioner,* 102 F. (2d) 103, certiorari denied 307 U. S. 627, the Court of Appeals for the First Circuit stated:

> "While the decision of the Court of Appeals for the Second Circuit may involve some doubt we do not regard it as clearly wrong and, being squarely in point, we follow it."

The foregoing decisions failed to give effect to the underlying theory of the privilege granted to husbands and wives in filing a joint return, embodied in Section 51 (b) (2). The very privilege is based upon disregarding the source; the spouses exercise it only when they can get some benefit from it; that is, when some loss of one can be set off against some gain of the other.

Moreover, the foregoing decisions have extended the scope of the limitation beyond the expressed purpose of Congress. The only purpose given by Congress for introducing the limitation upon the deductibility of securities losses in the 1932 Revenue Act was to prevent such losses from being offset against ordinary income, not to diminish

or destroy the pre-existing privilege of spouses to set off one's losses against the other's gains in a joint return.*

Substantially the same question, arising under the Revenue Act of 1934, Section 117 (d), was presented in *Janney* v. *Commissioner* (*supra*) and in the instant case. In the *Janney* case, the Court of Appeals for the Third Circuit rejected the majority opinion in the *Pierce* case. (108 F. [2d] at 566). In the instant case, the Court below affirmed the decision of the Board upon the authority of the *Pierce* case (R. 27).

The same question is presented by Section 117 (d) of the Revenue Act of 1936, which is identical in language with Section 117 (d) of the Revenue Act of 1934. Substantially the same question is raised by cognate provisions in Section 117 (d) of the Revenue Act of 1938 and of the Internal Revenue Code.

Thus, the question of federal law raised in the instant case has been presented to the Courts in numerous cases arising under the 1932 and 1934 Revenue Acts, has resulted in conflicting decisions, and will continue to be raised under the subsequent Revenue Acts, until definitely settled by decision of this Court.

Conclusion.

In view of the conflict of decisions and the general importance of the question presented, it is respectfully submitted that the petition should be granted.

Dated, May 17, 1940.

Chester Gaines and Theresa Gaines,
Petitioners.

By Frank E. Karelsen, Jr.,
Counsel for Petitioners.

Frederick Baum,
of Counsel.

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*See Sen. Rep. No. 665, 72d Cong. 1st Sess. p. 17; H. Rep. No. 708, 72d Cong. 1st Sess. p. 12; Hearings before Senate Finance Committee, 72d Cong. 1st Sess. p. 31; Hearings before Ways & Means Committee, 73d Cong. 2nd Sess. p. 46.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation, and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 51-1. *Individual returns.*—For each taxable year every single person and every married person not living with husband or wife for any part of the

taxable year, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is $1,000 or over, must make a return of income. Every married person living with husband or wife for any part of the taxable year, but not at the close of the taxable year, must make a return if his gross income for the taxable year is $5,000 or more, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family). (See article 25-7.) A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together at the close of the taxable year but not during the entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as the head of a family). (See article 25-7). If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the

deceased spouse in a joint return for such taxable year.

* * * * *

ART. 117-5. *Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

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IN THE

Supreme Court of the United States

October Term, 1940

No. 113

CHESTER GAINES and THERESA GAINES,
Husband and Wife,
Petitioners,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR THE PETITIONERS.

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October, 1940.

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BRIEF FOR THE PETITIONERS.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 15) is unreported. The opinion of the Circuit Court of Appeals is reported at 111 F. (2d) 144.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered May 8, 1940 (R. 27). The petition for writ of certiorari was filed May 29, 1940, and was granted October

14, 1940 (R. 29). The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Whether, under the Revenue Act of 1934, where a husband and wife living together file a joint return, the capital losses sustained by one spouse (in excess of $2,000) may be deducted from the capital gains of the other.

Statute and Regulations Involved.

The pertinent provisions of the Revenue Act of 1934 and of the regulations promulgated thereunder will be found in the Appendix, *infra*, pp. 26-30.

Statement.

The stipulated facts (R. 23-24) may be summarized as follows:

The petitioners were married and living together throughout the entire year 1934. During that year, the husband, Chester Gaines, realized a net gain (excess of his gains over his losses) from the sale of capital assets of $18,466.41, the entire amount of which was to be taken into account under Section 117(a) of the Revenue Act of 1934. The wife, Theresa Gaines, sustained a net loss (excess of her losses over her gains) from the sale of capital assets of $35,959.86, of which the amount to be taken into account under Section 117(a) of the Revenue Act of 1934 was $20,031.59 (R. 23-24).

The petitioners filed a joint income tax return for 1934. In this return, they reported a capital loss of $1,565.18,

which represented the difference between the husband's net capital gains taken into account ($18,466.41) and the wife's net capital losses taken into account ($20,031.59) (R. 24).

In auditing the return, the Commissioner held that the losses sustained by the wife could not be applied to reduce the gains realized by the husband, and that the wife's losses accordingly could be deducted only to the extent of her own gains, plus $2,000. By reason of this holding, the Commissioner added $18,031.59 to the net income reported by the petitioners (R. 24). On the basis of this adjustment, the Commissioner determined a deficiency of $5,008.55 (R. 13).

The Board of Tax Appeals sustained the Commissioner's decision (R. 16). The Circuit Court of Appeals affirmed the Board (R. 27). This Court granted certiorari (R. 29).

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1. In holding that under the Revenue Act of 1934, a loss sustained by one spouse from the sale of capital assets is not deductible to the extent of the gain realized by the other spouse from similar sales where a joint return is filed.

2. In holding that under the Revenue Act of 1934, the excess of the losses of one spouse over his or her gains from the sale of capital assets is not deductible from the gains of the other spouse from similar sales when a joint return is filed.

Summary of Argument.

Section 51(b) of the Revenue Act of 1934 entitles a husband and wife, if they so elect, to make a single joint return, in which case their tax is to be computed "on the aggregate income." Sections 23(e) and (j) and 117(d) together provide that losses from the sale of capital assets shall be allowed as deductions only to the extent of $2,000 plus the gains from such sales.

It is the petitioners' position that when a joint return is filed, the aggregate capital losses of both spouses may be deducted to the extent of the aggregate capital gains of both spouses, without regard to whether the spouse who sustained the loss was the one who realized the gain.

1. Section 51(b), authorizing joint returns, had been uniformly construed from 1921 to 1932 as entitling married taxpayers to offset the net loss of one against the net income of the other in a joint return. Prior to 1932, the revenue laws likewise contained a section entitling taxpayers to deduct the full amount of their losses in computing net income. By virtue of this section and the accepted meaning of Section 51(b), it had become long recognized that in a joint return, the losses of one spouse could be offset against the gains (or other income) of the other spouse.

In the 1932 and 1934 Acts, Congress reenacted Section 51(b) without change. It also reenacted the section permitting the full deduction of losses in computing net income, subject only to a later section which fixed a limitation thereon. Congress thus indicated its intention to continue undiminished the pre-existing scope of the joint re-

turn privilege (including the right to pool gains and losses), except in so far as the limiting provisions, embodied in Sections 23(r)(1) of the 1932 Act and 117(d) of the 1934 Act, might specifically otherwise provide.

Sections 23(r)(1) and 117(d) are devoid of any language purporting to diminish the pre-existing marital privilege with respect to pooling gains and losses. Deduction of losses is allowed "to the extent of * * * the gains from such sales" (which is true when one spouse's losses are offset against the other's gains in a joint return); it is forbidden only if it would diminish ordinary income. Moreover, the *sole* purpose given by Congress for enacting Sections 23(r)(1) and 117(d) was to prevent capital or security losses from reducing ordinary income. This purpose is completely fulfilled if the deductibility of the losses of both spouses is limited to the gains of both spouses in a joint return.

2. All of the Circuit Court opinions upholding the Commissioner's position rest solely upon the authority of *Pierce* v. *Commissioner*, 100 F. (2d) 397 (C. C. A. 2nd), construing Section 23(r)(1) of the 1932 Act. The majority opinion there (Judge L. Hand dissented) is based upon a supposed general rule that only such amounts may be deducted in a joint return as would have been deductible had separate returns been filed. The majority opinion refers to Article 381 of Regulations 77 and judicial decisions, but it is submitted that neither authority establishes such general rule. The petitioners contend that when a deduction is limited to a specified type of income, no such general rule controls but each such deduction must be considered in the light of its separate provisions

and purposes, as outlined in the preceding paragraph hereinabove.

3. The Commissioner relies upon Articles 381 of Regulations 77 and 117-5 of Regulations 86 as establishing a binding administrative construction. As stated in Judge Hand's dissent in the *Pierce* case, Article 381 is ambiguous; despite its inclusion in the regulations since 1921, the Commissioner in December, 1932, answered the very question here involved in favor of the petitioners. As to Article 117-5, as late as February, 1936, the Commissioner was following a practice and contending for a doctrine diametrically opposed to the principle announced in that article. Moreover, Section 51(b) was not reenacted in the 1938 Act, but was changed in various respects. In any case, as was pointed out in *Janney* v. *Commissioner,* 108 F. (2d) 564, 567 (C. C. A. 3rd), the Article is unwarranted under Section 51(b) as reenacted in the 1932, and 1934 Acts.

Argument.

1. The petitioners' construction is in accord with the evident intention of Congress.

The legislative background preceding the 1932 and 1934 Acts is important. In the revenue acts prior to 1932, Congress included a provision entitling husbands and wives living together to file a single joint return, if they so elected, in which case their tax was to be computed "on the aggregate income" (Sections 223 of the 1921, 1924, and 1926 Acts, and 51(b) of the 1928 Act). As early as 1921, the Commissioner ruled that this section entitled

married taxpayers to deduct the net loss sustained by one from the net income of the other when a joint return was filed (Sol. Op. 90, 4 Cum. Bull. 236). Recognizing that an inflexible rule requiring separate returns might result in collecting taxes from a family in a year in which, regarded as a single entity, it had sustained a net loss, Congress thus conferred on husbands and wives the right "in all cases to make a joint return and have the tax computed on the combined income" (H. R. No. 350, 67th Cong., 1st Sess., p. 13).

Congress also included in the revenue laws prior to 1932 a provision which entitled taxpayers to deduct the full amount of their losses in computing net income (Sections 214(a)(5) of the 1921, 1924, and 1926 Acts, and 23(e) of the 1928 Act). By virtue of this provision and the accepted meaning of the section permitting joint returns, it had become long established by 1932, that the losses of one spouse could be offset against the gains (or other income) of the other in a joint return.

In the Revenue Acts of 1932 and 1934, Congress reenacted without change the provision with respect to the filing of joint returns (Section 51(b)).[1] Likewise, Congress reenacted the section permitting the full deduction of losses in computing net income (23(e) of the 1932 and 1934 Acts), subject only to a later section which fixed a limitation upon such deduction (23(r)(1) of the 1932 Act and 117(d) of the 1934 Act). Congress thus indicated its

[1] Congress also preserved in the 1932 and 1934 Acts the differential in favor of husbands and wives by allowing them a joint personal exemption of $2,500 while giving other individuals an exemption of $1,000 (§25(c) of 1932 Act and §25(b) of 1934 Act).

intention to continue undiminished the pre-existing scope of the joint return privilege (including the established right of pooling gains and losses), except in so far as the limiting provisions in Sections 23(r)(1) and 117(d) might specifically otherwise provide.

Sections 23(r)(1) and 117(d) are devoid of any language purporting to diminish the pre-existing marital privilege with respect to offsetting one spouse's losses against the other's gains in a joint return. Section 23 (r)(1) provides that "Losses from sales or exchanges of stocks and bonds * * * which are not capital assets (as defined in Section 101) shall be allowed only to the extent of the gains from such sales or exchanges." Section 117(d) provides: "Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

The deductibility of losses is thus limited in only one respect—"to the extent of the gains from such sales or exchanges". Deduction of losses is permitted if it decreases gains but not if it diminishes ordinary income. Sections 23(r)(1) and 117(d) would permit the deduction in a joint return of one spouse's losses from the other's gains "if we take words in their plain popular meaning, as they should be taken here". *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, 3.

Not only are Sections 23(r)(1) and 117(d) devoid of any language purporting to curtail the prior scope of Sections 51(b) and 23(e), but the purpose of Congress in enacting the sections was entirely foreign to any such intention. The *only* purpose given by Congress for introducing the limitation upon the deductibility of security

losses in the 1932 Act was to *prevent such losses from being offset against ordinary income.* This was expressed in the following words by both the Senate and the House Committees which drafted the 1932 Act:

> "There are no provisions in existing law corresponding to Section 23(r) (s) and (t). Many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc., by deducting therefrom losses sustained in the stock and bond markets, with serious effect upon the revenue." (S. Rep. No. 665, 72d Cong., 1st Sess., p. 17; H. Rep. No. 708, 72d Cong., 1st Sess., p. 12.)

The same purpose was stated by the Secretary of the Treasury in his testimony before the Senate Committee in the hearings on the 1932 Act:

> "In recent years income from business profits, from salaries, and from other sources, has in many cases been offset by losses on security transactions. * * * In other words, people have been able through the taking of losses on sales of securities to wipe out any profits by way of dividends, or from business, and so forth. * * *
>
> "Now the Ways and Means Committee felt, and the Treasury agreed, that that abuse has grown to such a point that something ought to be done about it. * * * So the Treasury did agree with the Ways and Means Committee that you ought to limit the deduction of losses from the sale of securities to the amount of profits made in that same year from the sale of securities, and *that the loss resulting from*

sale of securities should not be used to wipe out other income." (Hearings before Sen. Finance Comm., 72d Cong., 1st Sess., p. 31.)

The House Subcommittee which worked upon the drafting of the 1934 Revenue Act likewise stated:

> "The Revenue Act of 1932 was enacted during a period of depression when the need for revenue was acute. It was known that the revenue from the income tax had greatly declined and a part of this decline was correctly ascribed to *the wiping out of ordinary income by the deduction therefrom of both classes of losses previously described.* The Congress therefore provided that the losses from sales of stocks and bonds held two years or less could only be taken to the extent of the gain from similar sales. *This prevented the reduction of ordinary net income from other sources by these losses."* (Hearings before Ways and Means Comm., 73d Cong., 2d Sess., p. 46.)[2]

[2] The same purpose that moved Congress to insert §23(r) (1) in the 1932 Act had caused Congress to introduce §208(c) into the 1924 Act (§101(b) of the 1932 Act). That section provided that capital net losses (the excess of losses over gains from sales of assets held over two years) could not decrease the tax (otherwise payable) by an amount in excess of 12½% of such capital net losses. The section was introduced into the revenue law because "the opportunity to minimize taxes by the practice of taking capital losses to offset ordinary net income constituted a particularly serious problem". *United States* v. *Pleasants,* 305 U. S. 357, 360. In fact, §23(r) (1) complemented §101(b) in the 1932 Act, for the former fixed the limitation with respect to losses from sales of noncapital stocks and bonds, while the latter fixed the limitation with respect to losses from capital assets.

This purpose of Congress, to prevent security losses from diminishing ordinary income, is fulfilled if the deductibility of security losses of both spouses is limited to the security gains of both spouses in a joint return. To permit one spouse to offset his or her security loss against the security gain of the other in a joint return would not and could not diminish the full taxability of the income of both spouses "from salaries, dividends, rents, etc."

The Commissioner's contention, however, requires the extension of the limitation prescribed in Section 23(r)(1) beyond the intention of Congress. It would not merely prevent a spouse from offsetting his or her security losses against ordinary income (which was all that Congress intended), but it would also deprive the spouse of the privilege (which had always been previously recognized under Sections 51(b) and 23(e)) of offsetting his or her secur-

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Yet the Commissioner has always recognized that under §101, the capital losses of one spouse may be offset against the capital gains of the other in a joint return. That Congress intended to make no distinction between the two sections in so far as the joint return privilege is concerned is shown by the fact that the draft of the 1932 Revenue Act adopted by the House (H. R. 10236) provided for the application of the limitation in §23(r) (1) to all securities. The Senate Committee eliminated this, stating: "The existing limitation, that capital losses cannot reduce the tax by more than 12½%, is adequate protection against excessive deductions." (S. Rep. No. 665, 72d Cong., 1st Sess., p. 10). At no time did the Committee or Congress refer to the proposed change as affecting the privilege of husband and wife to pool their gains and losses. It was apparently assumed that the privilege was the same under both §§101 and 23(r) (1).

ity losses against the other's security gains in a joint return.

With respect to the 1934 Act, the sole reason given for inserting the limitation (Section 117(d)) was the same as in the case of the 1932 Act. The House Committee explained the proposed restriction (Section 117(d)) by stating:

> "The method proposed is safe from a revenue standpoint, *inasmuch as capital losses cannot be used to reduce ordinary income* * * *." (H. Rep. No. 704, 73d Cong., 2nd Sess., p. 10.)

The House Committee which worked on the 1938 Revenue Act referred to Section 117(d) in the 1934 and 1936 Acts as follows:

> "The Committee believes that the principle adopted in the Revenue Acts of 1934 and 1936 *which denied the privilege of using capital net loss as an offset against ordinary income,* save within very narrow limits, should be adhered to at this time as a necessary and salutary safeguard of the income tax revenue." (H. Rep. No. 1860, 75th Cong., 3rd Sess., p. 37.)

Although there are additional statements declaring that the purpose in inserting Sections 23(r)(1) and 117(d) was to prevent security or capital losses from being deducted from ordinary income, nowhere in the record of the congressional committee reports or the debate on the floor of Congress is there any statement of any purpose to diminish in any way the pre-existing marital privilege of pooling gains and losses in a joint return.

2. The reasons and authorities referred to in the majority opinion in *Pierce* v. *Commissioner*, 100 F. (2d) 397 (C. C. A. 2d) do not support the decision.

All of the Circuit Court decisions upholding the Commissioner's position are based upon the precedent of *Pierce* v. *Commissioner*, 100 F. (2d) 397. There the Circuit Court of Appeals for the Second Circuit held that, under Section 23(r)(1) of the 1932 Act, the losses of one spouse from sales of securities constituting non-capital assets could not be offset against the gains of the other spouse from similiar sales in a joint return. Judge Learned Hand dissented. The same court ruled likewise in *Demuth* v. *Commissioner*, 100 F. (2d) 1012, certiorari denied, 307 U. S. 627.

The *Pierce* case was followed by the Courts of Appeals for the First and Fourth Circuits solely in deference to its prior precedent and not because of independent reasoning impelling the same conclusion.

Thus in *Nelson* v. *Commissioner*, 104 F. (2d) 521, the Court of Appeals for the Fourth Circuit indicated that a majority agreed with Judge Hand's dissent:

> "While a majority of this Court are much impressed with the reasoning of Judge Learned Hand in his dissenting opinion in the *Pierce* case, the legal question involved is a close one and we feel that we should follow the decisions of the First and Second Circuits, particularly in view of the denials of certiorari by the Supreme Court."

And in *Sweet* v. *Commissioner*, 102 F. (2d) 103, certiorari denied, 307 U. S. 627, the Court of Appeals for the First Circuit stated:

"While the decision of the Court of Appeals for the Second Circuit may involve some doubt we do not regard it as clearly wrong and, being squarely in point, we follow it."

Likewise, in the instant case, the *per curiam* decision below of the Court of Appeals for the Second Circuit affirmed the Board upon the authority of the *Pierce* case (R. 27). And in *Taft* v. *Helvering*, 111 F. (2d) 145, No. 183 this Term, certiorari granted, October 14, 1940, the same court held *per curiam* on the authority of the *Pierce* case, that the limitation on the deduction for charities to 15% of the taxpayer's net income (Section 23(o) of the 1932 Act) must be computed with reference to the husband's and wife's separate net income, and may not be computed on their combined net income, even though a joint return is filed.

Since the *Pierce* case constituted the sole authority relied upon by all of the lower court decisions in upholding the Commissioner's position, it is important to examine the reasons and authorities referred to in the majority opinion to see whether they support the decision.

The majority opinion in the *Pierce* case holds that the regulations and decisions

"contradict the petitioners' theory that husband and wife become a single taxable entity when they file a joint return; on the contrary each is treated as a separate individual who can carry deductions into the joint return only in his or her own right" (100 F. (2d) at 398).

The petitioners do not claim that there is any general rule that spouses filing joint returns are to be treated as

a single taxable entity; they base their case upon the considerations set forth under caption 1 hereinabove. But petitioners do contend that, contrary to the premise upon which the Court based the *Pierce* decision, there is no general rule that only such amounts may be deducted in a joint return as would have been deductible had separate returns been filed.

The majority opinion in the *Pierce* case bases this general rule not upon any provision of the revenue law, for there is none such, but upon Article 381 of Regulations 77 and judicial decisions.

Article 381 of Regulations 77 states that if a joint return is filed, "all deductions and credits to which either [spouse] is entitled shall be taken from such aggregate income." To determine the deductions to which either spouse is entitled, we must refer to the section defining the deductions to which an individual is entitled, which is Section 23 of the Revenue Act of 1932. This brings us right back to the correct meaning of Section 23(r)(1) of the 1932 Act—whether it limits the deductibility of security losses solely to the extent of requiring that their allowance should diminish security gains, or whether it extends further and abolishes the pre-existing privilege of spouses, embodied in Sections 51(b) and 23(e), to offset one's losses against the other's gains in a joint return. The answer to this question is to be found in the considerations set forth under caption 1 hereinabove. It is not supplied by referring to Article 381 (*supra*), for this merely directs us back to the original question of the correct meaning of Section 23(r)(1). As stated by Judge Hand in his dissenting opinion in the *Pierce* case, "* * *

it begs the question to say that the extent of the deduction under a separate return must be taken as a condition upon its existence" (100 F. (2d) at 398).

That the provisions of Article 381 constitute no bar to the petitioners' construction of Section 23(r)(1) is further shown by the fact that, despite their inclusion in the same form in all of the prior Treasury Regulations back to Article 401 of Regulations 62 (1921), the Commissioner on December 29, 1932, when this very question was submitted to him, expressed the opinion in a letter to the Commerce Clearing House that "The loss sustained by the husband would offset the same amount of gain realized by the wife from such source." (1933 C. C. H. Federal Tax Service, Vol. III, par. 6037). At the very least, this letter, signed by the Commissioner and bearing the symbols "RR" standing for the Rules and Regulations Section which draws up the treasury regulations, serves to indicate that the provisions of Article 381 constitute no clear statement that only such amounts may be deducted in a joint return as would have been deductible if separate returns had been filed.

Moreover, despite the inclusion of these provisions in the Regulations since 1921, the Commissioner in 1932 (*Frank B. Gummey*, 26 B. T. A. 894) and as late as 1936 (*Commissioner* v. *Brumder*, 82 F. (2d) 944 (C. C. A. 7th); *Commissioner* v. *Thomas*, 84 F. (2d) 562 (C. C. A. 5th)) was contending that the acts of husbands and wives should always be regarded as those of one person when a joint return is filed—a doctrine which goes beyond the petitioners' contention here and which would have automatically resolved the question in the instant case in favor of the petitioners.

The judicial decisions referred to in the majority opinion in the *Pierce* case likewise do not support the assumed general rule, that only such amounts may be deducted in a joint return as would have been deductible if separate returns had been filed. These cases allow one spouse to deduct in a joint return losses realized from sales to the other (*Commissioner* v. *Brumder, supra; Commissioner* v. *Thomas, supra; Hill* v. *United States*, 12 F. Supp. 798 (C. Cls.)); and to deduct losses on securities though the other spouse buys similar securities immediately thereafter (*Frank B. Gummey*, 26 B. T. A. 894). They merely recognize that the filing of a joint return does not automatically convert the transactions of husband and wife into those of one person, but the transactions continue to be given legal effect as those of separate persons. In the instant case, the acts of each spouse are recognized as producing separate legal results—the one spouse sustains losses and the other derives gains. After these acts are given their separate legal effect, the question in the instant case arises: does the limitation upon the deductibility of losses, embodied in Sections 23(r)(1) and 117(d), merely require that losses must offset gains (as petitioners contend that Congress intended) or does it go further and require that the same spouse who sustained the loss must have received the gain (as the Commissioner contends)?

Nor does the decision in *Van Vleck* v. *Commissioner*, 80 F. (2d) 217 (C. C. A. 2d), certiorari denied, 298 U. S. 656, lay down any such general rule. There the Court held that the net loss sustained by the husband in a year in which he filed a separate return might not be carried over and deducted from the income of the wife in a joint

return for the following year. The opinion relies upon the Supreme Court cases which declare that a carry-over deduction is an extraordinary right, not to be allowed unless the statute specifically so states:

> "The general principle underlying the income tax statutes ever since the adoption of the 16th Amendment has been the computation of gains and losses on the basis of an annual accounting for the transactions of the year. *Burnet* v. *Sanford & B. Co.*, 282 U. S. 359, 363, 75 L. ed. 383, 386, 51 S. Ct. 150. *A taxpayer who seeks an allowance for losses suffered in an earlier year, must be ablé to point to a specific provision of the statute permitting the deduction and must bring himself within its terms. Unless he can do this, the operations of the current year must be the measure of his burden.* * * * The points of difference between the allowances under §206(b) upon the one hand and those under §234 upon the other are important and obvious. The deductions allowable under §234 represent expenses paid or accrued or losses suffered during the same taxable year covered by the return. They are thus included in the net income according to the fundamental concept of such income reflected in the statute, instead of falling within *an exception which, irrespective of its precise extension, is a departure from the general scheme.*" (*Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 326, 329.) (Italics supplied.)

It is the position of the petitioners that where deductibility is limited to the amount of a specific type of income,

no general rule controls the question whether such deduction may be offset by one spouse against the other spouse's specified type of income in a joint return. Instead, each such deduction must be considered in the light of its separate provisions and purposes, as was done in the instant case in the discussion hereinabove under caption 1. Thus, the decision in *Van Vleck* v. *Commissioner* (*supra*) rested upon the peculiar provisions and purposes of the net loss carry-over deduction, "an exception * * * which is a departure from the general scheme". There was no background of construction, as in the instant case, under which husbands and wives had been entitled for years to offset the deduction in question against the other's income in a joint return; nor was the limitation subsequently enacted, as in the instant case, with the sole purpose of remedying a particular mischief, not touching in any respect the pre-existing privilege of spouses with respect to pooling such deduction in a joint return.

The adoption of any such general rule, that the filing of a joint return may not change the amounts which would have been deductible had separate returns been filed, may have repercussions upon a number of other sections of the revenue law, in some cases to the detriment of maximum revenues:

(1) Under the net loss carry-over deduction, which was contained in the revenue acts prior to 1932 and has been reinstated in the present law (Sections 23(s) and 122 of the Internal Revenue Code), the Commissioner has heretofore contended and it has been held, that where a joint return is filed, the income of the wife must be included in computing the net loss carry-over deduction

of the husband, thereby diminishing or wiping out the carry-over deduction to which the husband would have been entitled if he had filed a separate return (*Samuel G. Adams*, 19 B. T. A. 781; *William H. Shelmerdine*, 24 B. T. A. 833).[3]

(2) In computing the net loss carry-over deduction, capital losses are deductible only to the extent of capital gains and non-business deductions only to the extent of non-business gross income (Section 122 (d)(4)(5) of the Internal Revenue Code).

(3) Section 117(e) of the Internal Revenue Code provides that a net short-term capital loss may be carried over as a deduction in the following year, but limited to "an amount not in excess of the net income" for the current year. The 1932 Act contained a similar provision (Section 23(r)(2)). Where *H* has $100,000 net short-term capital loss in 1940 and $100,000 net income, considering his transactions alone, but files a joint return reporting no net income, he would be entitled to carry over into 1941 his net short-term capital loss if there were a general rule that deductions are to be allowed as though separate returns had been filed.

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[3] The same principle has been followed with respect to the consolidated returns of corporations, in cases in which the *Adams* decision *(supra)* was cited as authority. See *Kaiwiki Sugar Co.* v. *Burnet*, 63 F. (2d) 822, 824 (C. C. A. D. C.); *Crocker First Nat'l Bank of San Francisco*, 26 B. T. A. 1078, 1088.

3. The administrative construction does not support the Commissioner's position.

The Commissioner's contention with respect to the administrative construction is based upon Articles 51-1 and 117-5 of Regulations 86, promulgated under the Revenue Act of 1934.

Article 51-1 provides that when a joint return is filed, "* * * all deductions and credits to which either [spouse] is entitled shall be taken from such aggregate income". As pointed out (*supra*, p. 15), this provision is ambiguous and fails to state the answer to the question here involved; despite its inclusion in the Regulations since 1921, the Commissioner has contended in numerous cases since 1921 that the acts of husbands and wives are to be treated as those of one person when a joint return is filed, which is directly opposed to the interpretation now stated to have been expressed by this provision of the Regulations (*E. g. Frank B. Gummey*, 26 B. T. A. 894). Moreover, in December, 1932, the Commissioner answered the very question here involved in favor of the petitioners (*supra*, p. 16).

It was not until 1935, after the close of the taxable year here involved, that the Commissioner first gave notice through issuance of Article 117-5 of Regulations 86 and G. C. M. 15438, XIV-2, Cum. Bull. 156, that the earlier ruling would not be followed. Thus, taxpayers were lulled through the years 1933 and 1934 into the belief that the losses of one spouse could be offset against the gains of the other.

But even after the issuance of Article 117-5 (which specifically ruled in favor of the Commissioner as to the question at issue), the Commissioner continued to construe the law as requiring the transactions of husbands and wives to be regarded as those of one person when a joint return is filed. In February, 1936, the Commissioner filed a brief in the Fifth Circuit Court of Appeals in the case of *Commissioner* v. *Thomas,* 84 F. (2d) 562, and in the Seventh Circuit Court of Appeals in the case of *Commissioner* v. *Uihlein,* affirmed *sub nom. Commissioner* v. *Brumder,* 82 F. (2d) 944. The question involved in both cases was whether a loss sustained by one spouse from a sale made to the other was deductible in a joint return. In identical language, the Commissioner argued in both briefs as follows:

> "We submit that in providing for a 'single joint return' and a reporting of 'aggregate income', Congress intended to disregard the separate entities and to treat husband and wife, for tax purposes, as one. Their two incomes are brought together in a joint return as a unit, and their aggregate income is treated as though it were one income earned by one individual. * * * The Treasury Department at an early date so construed the statute. In I. T. 1575, II-1 Cum. Bull. 144, it was held that a joint return of husband and wife 'is one return of a taxable unit and not two returns of two units on one sheet of paper.' And in I. T. 1997, III-1 Cum. Bull. 149, *infra,* p. 18, it was held that 'such return is treated as the return of a taxable unit and the income disclosed by

the return is subject to both normal tax and surtax as though the return were that of a single individual."*

* * * * *

"The decision of the Board to the contrary is based on the previous Board decision in *Gummey* v. *Commissioner,* 26 B. T. A. 894, and was followed in the later Board decision in *Uihlein* v. *Commissioner,* 30 B. T. A. 399 (now pending on the Government's appeal to the Circuit Court of Appeals for the Seventh Circuit), and *Paul Speer* v. *Commissioner* (decided November 3, 1934, unreported), affirmed *per curiam* (C. C. A. 2nd), December 16, 1935. * * * In none of these cases did the Board answer the contentions here advanced by the Government. We submit the decisions are erroneous."

Thus in February, 1936, years after the issuance of the regulations under Section 51(b) and about a year after their issuance under Section 117(d), the Commissioner was following a practice and was urging a doctrine entirely inconsistent with that which he now states had been laid down and long continued under those regulations.

Moreover, as was pointed out in *Janney* v. *Commissioner,* 108 F. (2d) 564, 567 (C. C. A. 3rd), Section 51(b) was not reenacted in the 1938 Act, but various changes were made in the section, including a provision attach-

*Footnote in brief: "The above rulings were made in 1923 and 1924, respectively, following the adoption of the Revenue Act of 1921. Since that time, five revenue acts have been passed without change in the provision there interpreted. The rule of implied legislative approval would seem applicable."

ing joint and several liability to married taxpayers if they filed joint returns. In *Commissioner* v. *Rabenold,* 108 F. (2d) 639, (C. C. A. 2nd), the majority opinion held that the amendment of Section 51(b) in the Revenue Act of 1938 did not constitute merely a restatement in amplified form of the pre-existing law, and denied the joint and several liability of married taxpayers under the Revenue Act of 1933, basing its decision upon the authority of *Van Vleck* v. *Commissioner, Pierce* v. *Commissioner* and *Demuth* v. *Commissioner* (*supra,* pp. 13, 17), all of which cases are relied upon by the Commissioner in the instant case.

In any case, as the Court in *Janney* v. *Commissioner, supra,* likewise stated, Article 117-5 is not a construction warranted by the words of Section 51(b) authorizing the joint return. When Congress carried forward Sections 51(b) and 23(e) into the 1932 and 1934 Acts, it preserved the full scope of the pre-existing privilege of spouses to pool their gains and losses in a joint return, and the insertion of Sections 23(r) (1) in the 1932 Act and 117(d) of the 1934 Act, which neither in language nor in purpose purported to diminish this prior privilege, constituted no justification for the issuance of a regulation which impaired the established purview of Section 51(b).

Conclusion.

For the reasons stated, it is respectfully submitted that the decision of the Court below should be reversed.

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FRANK E. KARELSEN, JR.

October, 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.* In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * *

(2) if incurred in any transaction entered into for profit * * *

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

[U. S. C., Title 26, Sec. 51.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand

at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

[U. S. C., Title 26, Sec. 101.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 51-1. *Individual returns.*—For each taxable year every single person and every married person not living with husband or wife for any part of the taxable year, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is

$1,000 or over, must make a return of income. Every married person living with husband or wife for any part of the taxable year, but not at the close of the taxable year, must make a return if his gross income for the taxable year is $5,000 or more, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family). (See article 25-7.) A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together at the close of the taxable year but not during the entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as the head of a family). (See article 25-7.) If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year.

* * * * * *

ART. 117-5. *Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

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Art. 117-5. *Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

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In the Supreme Court of the United States

OCTOBER TERM, 1940

CHESTER GAINES AND THERESA GAINES, HUSBAND AND WIFE, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 113

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

We do not oppose the granting of a writ of certiorari in this case.

On April 29, 1940, this Court granted the Government's petition for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit in *Helvering* v. *Janney,* No. 843, October Term, 1939, and now pending for hearing as No. 36, October Term, 1940. The decision herein is in conflict with the decision in the *Janney* case (108 F. (2d) 564). While we think the decision of the court below is

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correct, we do not oppose the granting of the writ in view of the conflict and because it is important in the administration of the revenue laws that the question be settled.

Respectfully submitted.

ROBERT H. JACKSON,
Attorney General.

JUNE 1940.

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CITATIONS

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In the Supreme Court of the United States

October Term, 1940

No. 113

Chester Gaines and Theresa Gaines, Husband and Wife, petitioners

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 15) is unreported. The *per curiam* opinion of the Circuit Court of Appeals (R. 27) is reported in 111 F. (2d) 144.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 8, 1940. (R. 27–28.) The petition for a writ of certiorari was filed May 29,

1940, and was granted October 14, 1940. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under the Revenue Act of 1934, the filing of a joint return permits the wife's capital losses to be deducted from her husband's capital gains.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix *infra*, pp. 9–12.

STATEMENT

The facts, as stipulated (R. 23–24), may be summarized as follows:

The petitioners were married and living together as husband and wife throughout the calendar year 1934. During that year the husband, Chester Gaines, realized a net gain from the sale of capital assets of $18,466.41, the entire amount of which was to be taken into account under Section 117 (a) of the Revenue Act of 1934. During the same year his wife, Theresa Gaines, sustained a net loss from the sale of capital assets of $35,959.86, of which the amount to be taken into account under Section 117 (a) of the Revenue Act of 1934 was $20,031.59.

The petitioners filed a joint income tax return for 1934, in which they reported a capital loss of $1,565.18, which represented the difference between the husband's net capital gain taken into account ($18,466.41) and the wife's net capital losses taken into account ($20,031.59).

In auditing the return, the Commissioner held that the losses sustained by the wife could not be applied to reduce the gains realized by the husband, and that the wife's losses accordingly could be deducted only to the extent of her own gains, plus $2,000. By reason of this holding, the Commissioner added $18,031.59 to the net income reported by the petitioners. On the basis of this adjustment, the Commissioner determined a deficiency of $5,008.55 (R. 13).

The Board of Tax Appeals sustained the Commissioner's determination (R. 16). The Circuit Court of Appeals affirmed (R. 27), *per curiam,* the order of the Board, upon the authority of that court's decision in *Pierce* v. *Commissioner,* 100 F. (2d) 397. This Court granted certiorari (R. 29).

ARGUMENT

The question presented in this case is precisely the same as that in *Helvering* v. *Janney,* No. 36, this Term, to be argued immediately preceding this case. Both cases arise under the Revenue Act of 1934. Hence, we adopt for this case the brief on behalf of the Commissioner of Internal Revenue in the *Janney* case. Here we discuss only those of

the arguments advanced by the petitioners which are not covered in the brief for the Commissioner in the *Janney* case.

1. The petitioners' principal argument in the present case is that prior to enactment of the Revenue Act of 1932 the right of husband and wife to pool their losses in a joint return embraced the right here claimed, that Congress had no purpose "to diminish this prior privilege" by the insertions of Section 23 (r) (1) in the 1932 Act and 117 (d) in the 1934 Act, and that the adoption of the provisions hence did not justify the Treasury in promulgating regulations in derogation of the "prior privilege." But the specific question here at issue arose only with the enactment of Section 23 (r) (1) of the 1932 Act, providing that losses from sales or exchanges of stocks and bonds held by the taxpayers for less than two years should be allowed only to the extent of gains from such sales or exchanges.[1] And so far as that question was determinable according to general principles, the predecessors of Article 51-1 of Regulations 86, providing that if

[1] "There are no provisions in existing law corresponding to Section 23 (r), (s), and (t)." S. Rept. No. 665, 72d Cong., 1st Sess., p. 17.

The petitioners apparently suggest (Br. 10, note 2) that the question at bar arose under Section 208 (c) of the 1924 Act and its successors (Revenue Act of 1926, Section 208 (c); 1928, Section 101 (b); 1932, Section 101 (b)), and that the right here claimed by the taxpayers was accorded in the administration of that provision. Section 208 (c) provided that in the case of any taxpayer who sustained a capital net loss (i. e. a loss from the sale or exchange of property held

a joint return were filed the tax should be computed on the aggregate income and that all deductions "to which either is entitled" should be taken from such aggregate income, gave notice that it was the Treasury's general position that before any deduction might be entered in a joint return it must be a deduction to which either the husband or the wife, separately considered, was entitled under the law.

2. In *Pierce* v. *Commissioner,* 100 F. (2d) 397 (C. C. A. 2d), and in the brief for the Commissioner in the *Janney* case, various decisions are referred to in support of the proposition that even though husband and wife file a joint return "each is treated as a separate individual who can carry deductions into the joint return only in his or her

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for more than two years) the tax should be determined by computing a tax upon the ordinary net income at the usual rates and by deducting from this tax 12½ per centum of the capital net loss. This section further provided that in no case should the tax computed under it be less than the tax computed without reference to it. Because of the provision last referred to, Section 208 (c) was operative only with respect to capital losses which would otherwise have been offset against income taxable at the rate of 12½ per centum or more. Section 208 (c) was correlative to Section 208 (b), which permitted a taxpayer to elect that his net capital gain be taxed at the rate of 12½ per centum instead of at the rate otherwise applicable.

Section 208 (c), unlike the statutory provisions involved here and in the *Taft* case No. 183, argued herewith, did not make the amount of or the right to the deduction contingent upon the amount or kinds of income of the taxpayer. Hence it was unnecessary to the policy of the Section that one spouse be prohibited from deducting the capital losses of the other; there was no more reason to prohibit the pooling of such deductions than of other deductions.

own right" (100 F. (2d) at 398). Petitioners assert that the decisions so refered to do not support the proposition for which they are cited, and, at the same time, that the position unsuccessfully taken by the Commissioner in some of these cases was inconsistent with his present position. We think, on the other hand, that the positions taken in those cases were not inconsistent with the present position of the Treasury, for the reason that those cases presented special considerations which might have removed them from the operation of the principle that a husband and wife remain separate individuals for the purpose of computing their deductions even though they file a joint return. And certainly the cases stand for this principle, since the courts refused to exclude them from its scope, despite the presence of factors which might have induced the courts to do so.

The earliest of these cases is *Frank B. Gummey* v. *Commissioner,* 26 B. T. A. 894 (1932). There the Board held that husband and wife were to be treated as separate individuals for purposes of the "wash" sale provision, i. e., that a deduction might be taken in a joint return for losses sustained by one spouse on the sale of securities even though the other spouse brought similar securities immediately thereafter.[2] Similarly held that losses

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[2] The Bureau acquiesced in this decision, XIII-2 Cum. Bull. 8, and overruled its prior ruling to the contrary. I. T. 2824, XIII-2 Cum. Bull. 293, overruling I. T. 1997, III-1 Cum. Bull. 149.

stained by one spouse in a bona fide sale of securi-
es to the other spouse could be deducted in a joint
turn. *Commissioner* v. *Thomas,* 84 F. (2d) 562
C. C. A. 5th); *Joseph E. Uihlein* v. *Commissioner,*
) B. T. A. 399 affirmed *sub nom Commissioner* v.
rumder, 82 F. (2d) 944 (C. C. A. 7th); *Hill* v.
nited States, 12 F. Supp. 798 (C. Cls.). In those
ses a contrary result might well have been
ached as necessary to prevent tax evasion, with-
it abandoning the position that husband and wife
re not, as a general proposition, to be treated as
single taxpayer even if they file a joint return.
t was to close the avenue of tax evasion opened by
iese decisions, and not as an outgrowth of any
ngle taxpayer theory, that Congress provided in
ection 24 (b) (1) of the Revenue Act of 1938 that
o deductions should be allowed for losses result-
ig from sales between members of a family.[3]
ee H. Rep. No. 704, 73d Cong., 2d Sess., p. 23;
939-1 Cum. Bull. 554, 571; 78 Cong. Rec. 2662.
ee also (1940) 53 Harv. L. Rev. 681, 682; (1940)
9 Yale L. J. 1279, 1283. The position taken by
he Bureau in those cases was thus not inconsistent
ith, and the holdings of the courts support, its
osition here.

Similarly the position taken by the Commis-
ioner that spouses filing a joint return were

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[3] Whether this amendment reaches the question which was
resented in the *Gummey* case, or only that involved in the
homas, *Brumder*, and *Hill* cases, is not clear. See (1940)
9 Yale L. J. 1279, 1283, note 35.

jointly and severally liable for the tax was necessary as a matter of administration, because of the difficulty of determining the proportion of the tax liability attributable to each spouse. Congress so recognized in inserting in Section 51 (b) of the 1938 Act a provision explicitly making liability for the tax joint and several. See H. Rept. No. 1860, 75th Cong., 3d Sess., pp. 29–30. But the cases rejecting the Commissioner's contention support the view that a husband and wife remain separate taxpayers even though they file a joint return. *Cole* v. *Commissioner,* 81 F. (2d) 485, 487 (C. C. A. 9th); *Crowe* v. *Commissioner,* 86 F. (2d) 796 (C. C. A. 7th); *Commissioner* v. *Rabenold,* 108 F. (2d) 639 (C. C. A. 2d).

CONCLUSION

For the reason stated in the brief for the Commissioner in the *Janney* case and herein it is submitted that the judgment of the court below should be affirmed.

Respectfully submitted.

ROBERT H. JACKSON,
Attorney General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
MAURICE J. MAHONEY,
THOMAS E. HARRIS,
Special Assistants to the Attorney General.

NOVEMBER 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SECTION 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

(U. S. C., Title 26, Sec. 51.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital

asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

(U. S. C., Title 26, Sec. 101.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 51-1. *Individual returns.*—For each taxable year every single person and every married person not living with husband or wife for any part of the taxable year, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is $1,000 or over, must make a return of income. Every married person living with husband or wife for any part of the taxable year, but not at the close of the taxable year, must make a return if his gross income for the taxable year is $5,000 or more, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family). (See article 25-7.) A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together at the close of the taxable year but not during the entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3). (Computed without regard to the status of either of them as the head of a family.) (See article 25-7.) If the income of each is included in a single joint return, the tax is

computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year.

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ART. 117-5. *Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

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SUPREME COURT OF THE UNITED STATES.

Nos. 36 and 113.—OCTOBER TERM, 1940.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 36 *vs.* Walter C. Janney and Pauline F. M. Janney.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.
Chester Gaines and Theresa Gaines, Petitioners, 113 *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 9, 1940.]

Mr. Chief Justice HUGHES delivered the opinion of the Court.

These cases present the same question, that is, whether under the Revenue Act of 1934, in the case of a joint return by husband and wife, the capital losses of one spouse may be deducted from the capital gains of the other.

In *Helvering* v. *Janney,* the wife realized net gains from the sale of capital assets during 1934, and the husband realized net losses from the sale of capital assets during the same year. They filed a joint income tax return reporting the capital gain, which represented the difference between the wife's adjusted capital gains and the husband's adjusted capital losses. The Commissioner ruled that the husband's losses could not be applied to reduce the gains realized by his wife and accordingly determined a deficiency. The Board of Tax Appeals sustained the Commissioner (39 B. T. A. 240) but the Circuit Court of Appeals for the Third Circuit reversed. 108 F. (2d) 564.

In *Gaines* v. *Helvering,* the husband realized a net gain from the sale of capital assets during 1934, while his wife sustained a net loss from the sale of capital assets. They filed a joint return reporting a capital loss, which represented the difference between the husband's net capital gain and his wife's net capital loss. The Commissioner, as in the *Janney* case, decided against this adjustment and the Board of Tax Appeals affirmed. The Circuit Court of Ap-

peals for the Second Circuit affirmed the decision of the Board. 111 F. (2d) 144.

In view of the conflict between these decisions, we granted certiorari. No. 36, 310 U. S. 617; No. 113, October 14, 1940.

Section 51(b) of the Revenue Act of 1934[1] with respect to the returns of husband and wife provided:

"(b) Husband and Wife.—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

"(1) Each shall make such a return, or

"(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income".

The same provision in substance is found in the earlier Revenue Acts from that of 1921.[2]

The "aggregate income", to which paragraph 2 of Section 51(b) refers, is clearly the aggregate net income as it is the aggregate income on which "the tax is to be computed". In that view the deductions to which either spouse would be entitled would be taken, in the case of a joint return, from the aggregate gross income.

That was the construction placed upon the provision for a joint return in the Revenue Act of 1918 by the Solicitor of Internal Revenue in an opinion rendered in 1921.[3] After considering the terms of the statute and the reasonable inference as to the intent of Congress, the Solicitor concluded:

"From the foregoing it follows that the proper construction of the Revenue Act of 1918 permits a husband and wife living together, at their option, to file separate returns or a single joint return. If a single joint return is filed it is treated as the return of a taxable unit and the net income disclosed by the return is subject to both normal and surtax as though the return were that of a single individual. In cases, therefore, in which the husband or wife has allowable deductions in excess of his or her gross income, such excess

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1 48 Stat. 697.

2 The Revenue Act of 1918, Section 223, also provided for a joint return by husband and wife. 40 Stat. 1074.

Section 223(b) of the Revenue Act of 1921 provided (42 Stat. 250):

"(b) If a husband and wife living together have an aggregate net income for the taxable year of $2,000 or over, or an aggregate gross income for such year of $5,000 or over—

"(1) Each shall make such a return, or

"(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income".

3 Sol. Op. 90, Cum. Bull. No. 4, p. 236 (1921).

may, if joint return is filed, be deducted from the net income of the other for the purpose of computing both the normal and surtax''.

The terms of the Revenue Act of 1921 made this view even clearer.[4] Treasury Regulations 62, Article 401, promulgated under the Revenue Act of 1921, apparently followed the same view. That article provided as to joint returns of husband and wife,—

''Where the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income''.[5]

The question as to deductions for losses on sales or exchanges of securities arose under Section 23(r)(1) of the Revenue Act of 1932.[6] That provided that losses as there described should be allowed only to the extent of gains derived from such sales or exchanges. Nothing was said in this section which in any way affected the provision of the statute as to joint returns by husband and wife. The question in that relation, that is, as to deduction for losses on sales of securities, was submitted to the Commissioner of Internal Revenue and was answered by him on December 29, 1932, as follows:

''The specific question presented is whether the loss sustained by the husband may be applied to offset the same amount of gain realized by the wife in rendering joint income tax return for the year. In reply you are advised that, in the case of a husband and wife living together who file a joint income tax return, the tax liability is computed on the aggregate income as provided by section 51(b)(2) of the Revenue Act of 1932, and such joint return is

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4 The Committee on Ways and Means of the House of Representatives reported with respect to the provision of the bill which became the Revenue Act of 1921 as follows:

''Section 231 of the bill proposes to amend Section 223 of the present law in such a manner as to clear up the doubt now existing as to the right of husband and wife in all cases to make a joint return and have the tax computed on the combined income''. House Rep. No. 350, 67th Cong., 1st Sess. See, also, Sen. Rep. No. 275, 67th Cong., 1st Sess.

5 The same provision was continued in substance in succeeding regulations. Article 401 of Treasury Regulations 65 and 69 under the Revenue Acts of 1924 and 1926; Article 381 of Regulations 74 and 77 under the Revenue Acts of 1928 and 1932.

6 47 Stat. 183. Section 23(r)(1) provided: ''Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

treated as if it was the return of a single individual. The aggregate income in such case would of course embrace the gains as well as the allowable deductions of each spouse. If it is correctly understood from your letter that the gains and losses in the illustration presented are from transactions falling within the same class within the meaning of the statute such as sales of securities not held for a period of more than two years, the loss sustained by the husband would offset the same amount of gain realized by the wife from such source''.[7]

This statement by the Commissioner applied the same principle which had previously been followed with respect to deductions in the joint returns of husband and wife, there having been no indication by Congress of any different purpose.

Treasury Regulation No. 77, promulgated under the Act of 1932, contained nothing to the contrary and the regulation theretofore obtaining as to such joint returns was left unchanged. Art. 381.

The Revenue Act of 1934 continued the prior statutory provisions as to joint returns of husband and wife, and Section 117(d) of that Act, as to capital losses, did not purport to alter the rule as to the right of the spouses to deductions in their joint return. Section 117(d) merely limited the amount of losses which could be deducted, as follows:

''(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges''.

The conclusion of the Commissioner with respect to the Act of 1932, in the opinion above mentioned, was equally applicable to the new Act.

It was not until 1935 that the Treasury Department by Article 117-5 of Regulations 86 undertook to provide that ''the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets''.[8]

We are of the opinion that under the provision of the Act of 1934 as to joint returns of husband and wife, which embodied a policy set forth in substantially the same terms for many years, Congress intended to provide for a tax on the aggregate net income and that the losses of one spouse might be deducted from the gains of the

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7 1933 Commerce Clearing House Federal Tax Service, Vol. III, par. 6037.

8 It was also in 1935 that the Bureau of Internal Revenue announced the same ruling under the Act of 1932. G. C. M. 15438, Cum. Bull. XIV-2, p. 156.